How affirmative action slows the economy

Performance rankings on 1,065 mutual funds

February 15, 1993 Four Dollars

Forbes


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Forbes
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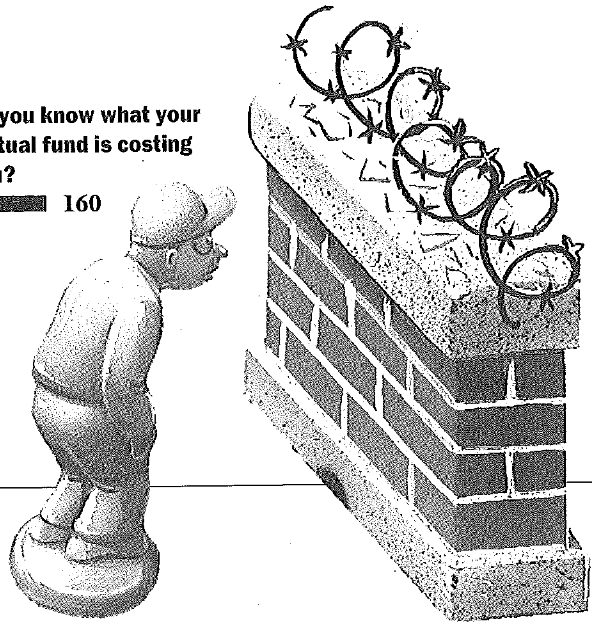

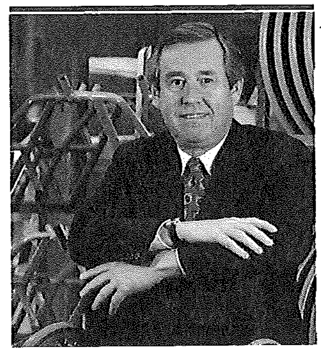

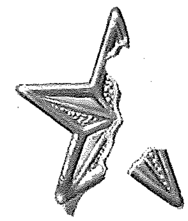

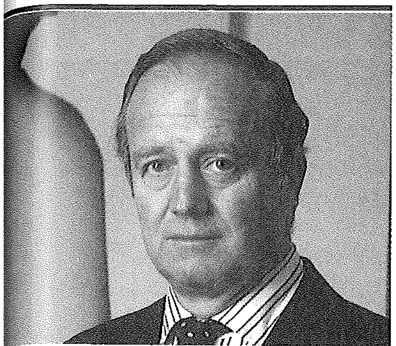

Madison Avenue's exceptional case.
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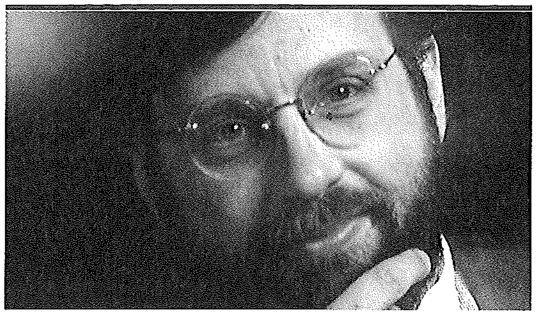

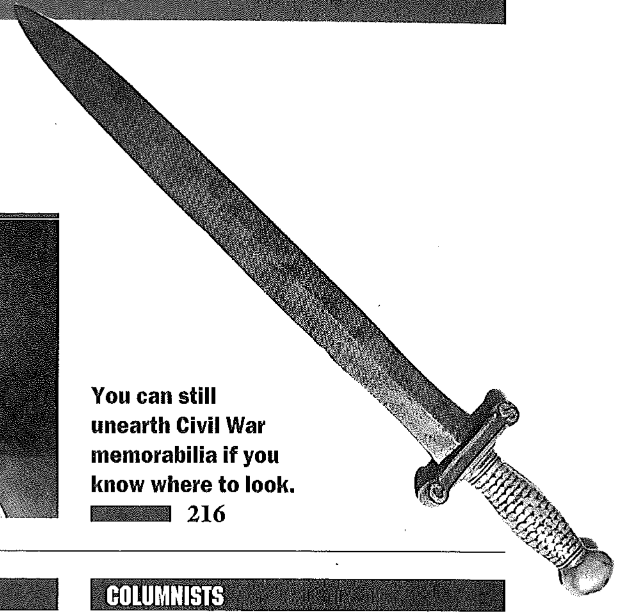

You can still unearth Civil War memorabilia if you know where to look.
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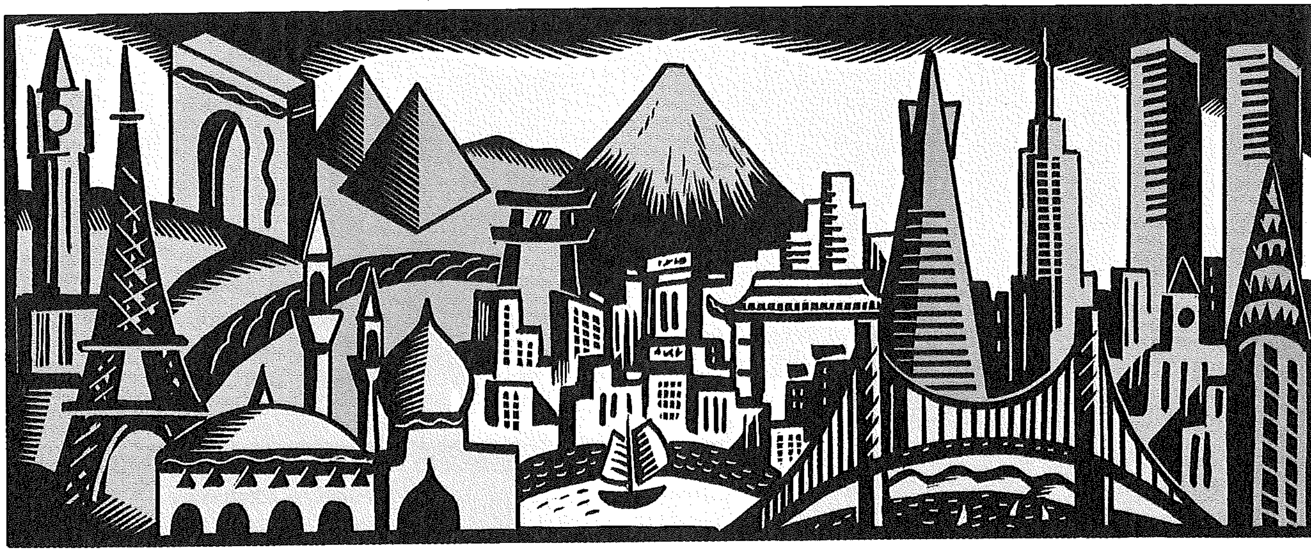

MATSUSHITA LAUNCHED

the first global corporate bond offering ever, and demonstrated that choosing the right road is as important as knowing the right destination.

COMPANIES IN THIS ISSUE

Forbes

EACH REFERENCE IS TO THE FIRST PAGE OF THE STORY IN WHICH THE COMPANY NAME APPEARS.

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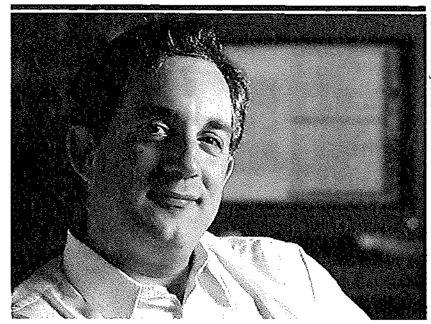
SIDE LINES

The E-mailman


Shawn Henry/SABA

Lotus founder Mitchell Kapor

SOFTWARE GURU Mitchell Kapor is founder of Lotus Development Corp., whose spreadsheets helped make the PC into the ubiquitous business tool it has become. Kapor tends to speak tersely, sparingly in person, but he's loquacious on E-mail. So that's the way FORBES computer/communications reporter David Churbuck often interviews him—via E-mail. And that's how Kapor became a FORBES guest columnist.

Churbuck ran into Kapor at Esther Dyson's computer conference last year. Seizing the opportunity, Churbuck blurted out something he had talked about with his editors: "Mitch, why don't you write a column for FORBES?" A few months later Churbuck got an E-mail query from Kapor: Does the column offer still stand?

It still stood. Kapor's first column appeared last November. The second is in this issue. It came, of course, via modem, but it appears in a form even the computer-nonliterate can read on page 208.

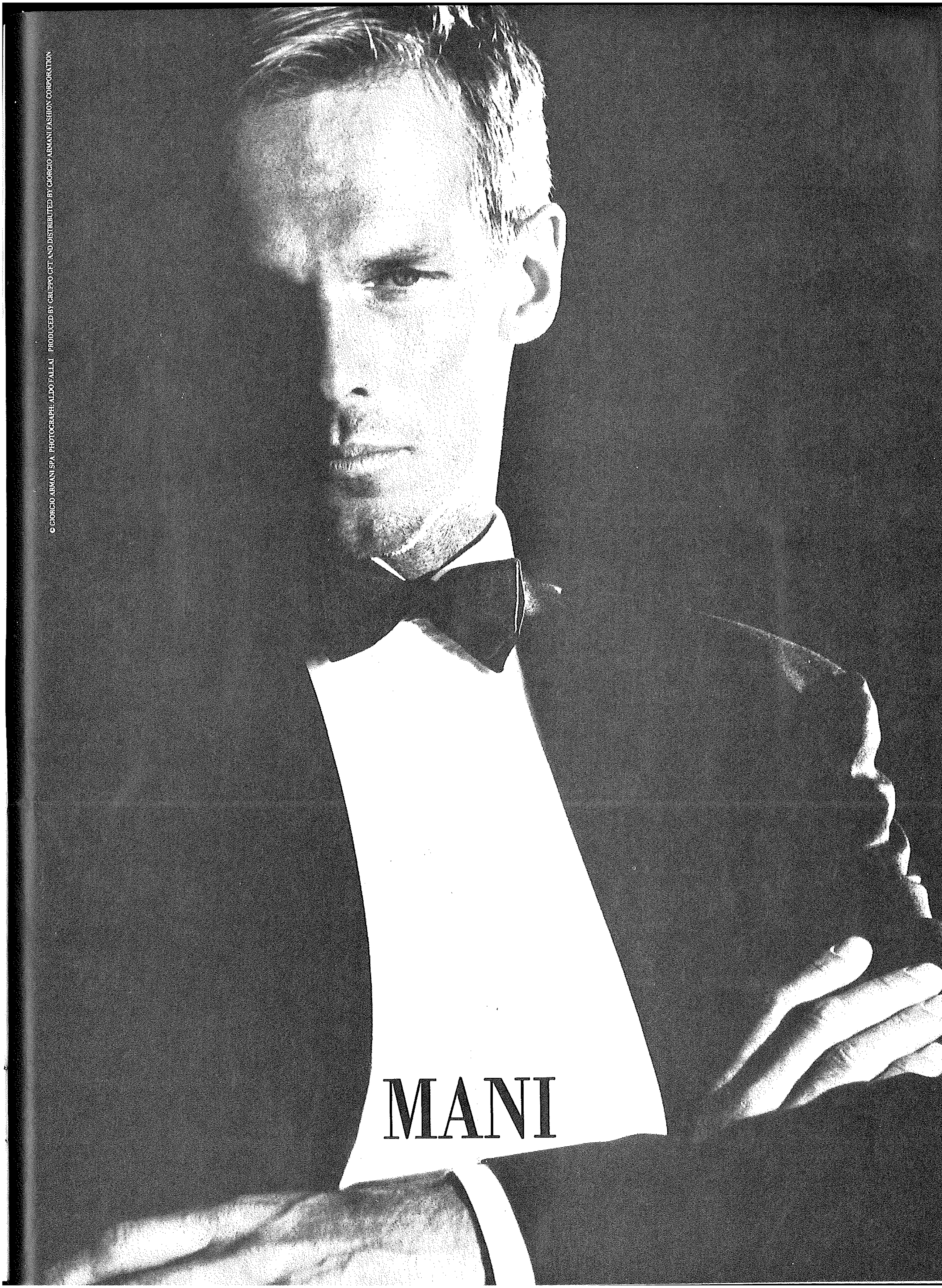
Have civil rights become quota wrongs?

UNDER THE benign-sounding name of affirmative action, racial, linguistic and gender quotas are permeating American life. They influence hiring and promotion and purchasing decisions. Admission to elite universities and professorial appointments. Government contracts and civil service hiring. The media even parse Cabinet appointments by race, gender and ethnicity, as President Clinton learned to his anger. But there is precious little discussion in the media about the rights and wrongs of quotas. Peter Brimelow and Leslie Spencer tackle the touchy subject in "When quotas replace merit, everybody suffers." Turn to page 80.

How thorough?

FOR THEIR ARTICLE "Who pays the piper . . . " Dana Wechsler Linden and Neil Weinberg did an exceptional amount of detective work, running down sources in places as far apart as South Carolina, India, Dubai, Northern England and Panama. They found some scary things about a company called Ross Cosmetics. Yet Ross had only recently been given a pretty clean bill by a distinguished law firm—one of many U.S. companies that have hired outside lawyers to investigate charges against them. The FORBES writers looked at Ross and a couple of other outfits similarly cleared and came away full of doubts about these investigations by special counsel. Page 126.

James W. Michaels
Editor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MANI

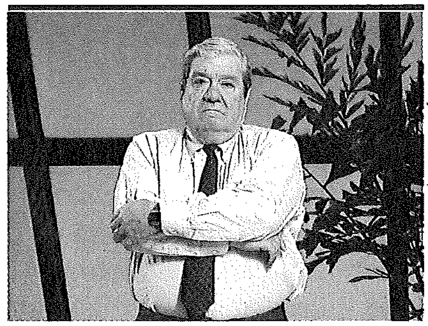
How to s

Disappointment

JUST AS Texaco Inc. underestimated Pennzoil Co. Chairman J. Hugh Liedtke, so FORBES may have overestimated him. Liedtke's company won $3 billion in 1988 from Texaco in the famous battle for Getty Oil, but by late 1990 Pennzoil's stock, which peaked at 95 in 1987, was down to about 67. Noting that Liedtke was "a master at producing miracles," FORBES declared: "Don't bet on his sitting helplessly" *(Dec. 10, 1990)*.

Liedtke hasn't done much in the interim to live up to that billing. He did avoid a potential $800 million income tax hit on the Texaco windfall by buying around 9% of Chevron's common stock, then swapping half of it back to Chevron for energy reserves, doubling Pennzoil's oil production and raising its natural gas production by 75%. Pennzoil also sold about $400 million of debentures convertible into a small portion of the remaining Chevron stake.

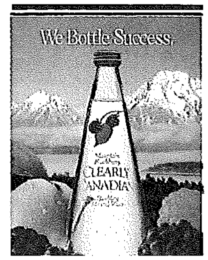
But all this hasn't done much for shareholders. Pennzoil has not earned its $3 dividend since 1989; analysts estimate it will show just $2.75 a share this year, and that's a lot better than 1992's 85 cents. Still, Pennzoil stock is mired at around 50, barely half its old high. —WILLIAM P. BARRETT


Dan Ford Connolly/Picture Group

Pennzoil Chairman J. Hugh Liedtke
He hasn't lived up to his billing.

Clearly chastened

WHEN WE PANNED Vancouver's Clearly Canadian Beverage Corp. 15 months ago *(Nov. 11, 1991)*, several stockbrokers wrote in to pan us. Didn't FORBES know about the smashing success of Clearly Canadian's sparkling water flavors, with countrified names like Orchard Peach and Mountain Blackberry? Who was FORBES to say that after running from 3½ to 24¾ in less than a year and trading at 50 times trailing earnings, Clearly Canadian's Nasdaq-listed stock was getting ahead of itself? And so what if Clearly Canadian had arisen from the corporate ashes of faddish Jolt Beverage Co., whose stock collapsed in 1987?



After losing over half its market value, is the company finally a buy?

Turns out this was one of our better calls. True, Clearly Canadian's stock, after dropping to 15 in the wake of our story, recovered to 25 early last year. But it's been downhill ever since. Recent price: 9⅛.

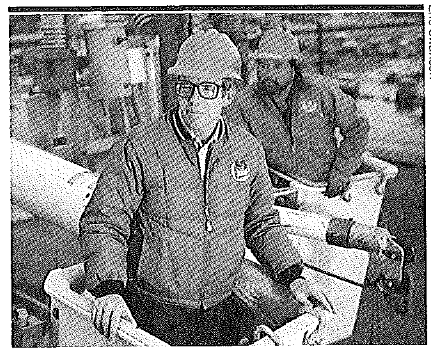
Although volume increased 25% in 1992, to some 23 million cases, it fell in the second half from year-ago levels. Clearly Canadian President Douglas Mason blames the drop-off on the weather—a cool summer caused a temporary inventory bubble at the distributor level, he says.

But Clearly Canadian is also encountering tough new competition from Perrier and Coca-Cola; the latter is test-marketing Nordic Mist, a flavored sparkling water. In response, Clearly Canadian and its distributors will double marketing expenditures this year, to $25 million. Moreover, having expanded distribution last year to Japan, Mexico and most of the Caribbean, Mason is now cutting a European distribution deal. "The company, in our opinion, has never been in better shape," Mason recently told FORBES. He predicts revenue growth of 20%-plus through 1994.

But Jennifer Solomon, an analyst at Mabon Securities, isn't persuaded. She expects earnings of $1.25 this year, up from an estimated 88 cents in 1992. If it makes that number, Clearly Canadian is selling for a very modest seven times anticipated earnings. Yet Solomon rates the stock a hold. "If we get comfortable that volume trends will improve," she says, "we will go to a buy."

Popular revolt

YOU RARELY SEE the chief executive of a public company lose his job because of a public referendum. But that seems to be the fate of John Ackerman, head of troubled Public Service Co. of New Mexico. By a margin of better than 2-to-1, in December citizens of Albuquerque defeated a Public Service-backed referendum that in effect would have extended the utility's monopoly to provide electricity for another 15 years.



Eric Swanson

Public Service's John Ackerman
Albuquerque's voters said no.

Why the defeat? As FORBES recently reported, during the 1980s Public Service had turned off its shareholders and customers alike by botching its diversification efforts and by maintaining electric rates that are relatively high for the region *(Dec. 7, 1992)*.

Ackerman, who took over from Jerry Geist in 1990, tried to repair the damage and had made some progress. But the voters could not be ignored. Last month Ackerman, 51, announced he will relinquish his duties as chief executive after a replacement is found; he will continue to be chairman. The utility also announced layoffs and other executive departures, and accelerated plans to sell off unwanted generating capacity, a small water company and other assets.

The company will continue to serve Albuquerque, which accounts for about half of its $857 million in annual revenues. But shorn of its monopoly powers and with massive debt to service, Public Service faces a less certain future. A rival outfit could seek permission to lower rates, or another utility could make a hostile bid for Public Service. Stay tuned.

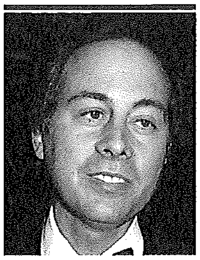
—W.P.B.

FORBES INFORMER

EDITED BY THOMAS JAFFE

Head chopping time

BRANDON TARTIKOFF, the entertainment whiz whose resignation last year as chief of Paramount Communications' movie studio caused such a stir, is rumored to be back as a consultant with his old employer NBC. His hush-hush assignment? To recruit a replacement for NBC Entertainment President Warren Littlefield. It could



Lisa Rose/Globe

L.A. Daily News/Gamma-Liaison

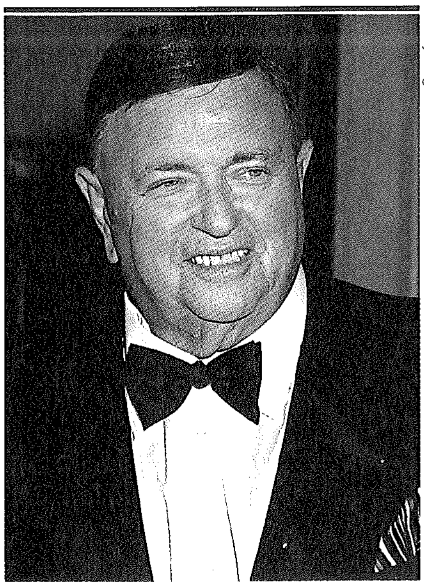
Brandon Tartikoff Warren Littlefield

Will NBC get the right man this time?

be a touchy task for Tartikoff because Littlefield was Tartikoff's protégé at NBC for five years and his hand-picked successor. But the job's got to be done: NBC has sunk to third in the ratings war since Littlefield succeeded Tartikoff in 1991.

Aspen adieu?

BILLIONAIRE Marvin Davis may be negotiating to sell his 50% interest in the Aspen Skiing Co. to Chicago-based developer Norman Perlmutter. (The other half is owned by Chicago's Crown family.)



Anthony Savignano/Ron Galella

Billionaire Marvin Davis

Taking a powder from the powder?

According to the *Aspen Daily News,* Perlmutter has told members of the Snowmass town council that he and Davis have reached an agreement. The report makes sense because Perlmutter and partner Eugene Golub already control the Snowmass Land Co., which plans to develop property around Aspen's Snowmass ski resort, one of the three Aspen ski resorts owned and operated by Aspen Skiing Co. (Its other two are Aspen and Taehack-Buttermilk.) Aspen Skiing Co. also has some choice real estate, including the swank Little Nell hotel, at the base of Aspen Mountain.

Neither Davis nor Perlmutter would comment on the story, but Davis is believed to be asking for at least $75 million. –JOHN H. TAYLOR

Hostage tax

SEVERAL BIG Wall Street firms have found a new source of income: account transfer fees. Shearson Lehman Brothers and Smith Barney Harris Upham will soon join Prudential Securities in billing customers $50 if they move their accounts to another brokerage. The charge is said to cover the cost of processing paperwork. Brokers at firms lacking such an exit fee have gleefully taken to calling it a "hostage tax."

Here's a way to avoid paying the penalty if you move your account: Ask your new broker to reimburse you for the old broker's exit fee. Given the competitiveness of the securities industry, the new broker is unlikely to say no. –WILLIAM P. BARRETT

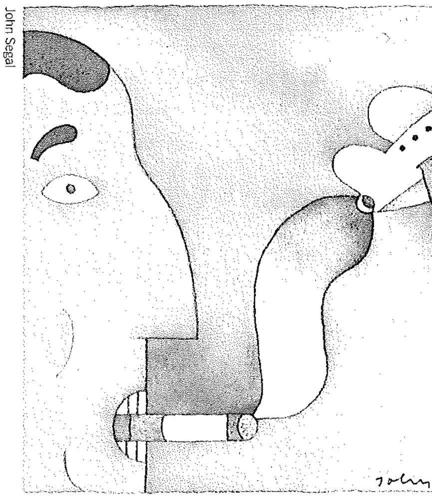
Lighting up the skies

LAST YEAR 32 new U.S. airlines took to the skies, each with its own gimmick to attract passengers. Now comes Smokers Express Airlines.

You guessed it. Smokers Express will allow passengers to smoke their hearts and lungs out on the nonstop service it hopes to offer (at competitive prices) from the Space Coast executive airport, in Titusville, Fla., to Orlando, Atlanta, Chicago, Dallas, Las Vegas and Atlantic City.

Smokers Express is the brainchild

John Segal



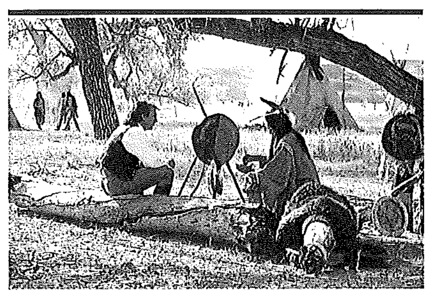
of William Walts and George (Mickey) Richardson, a couple of Cocoa Beach, Fla. businessmen who like to smoke. How will they get around the Federal Aviation Administration's ban on smoking on domestic flights? By incorporating the airline as a travel club and recruiting members at $25 in annual dues. They say they already have 500 members, and are now seeking FAA certification.

Richardson says he hopes to finance some of Smokers Express' $3.5 million startup costs by selling sponsorships to tobacco companies.

–CLAIRE POOLE

Dances with McDonald's

DURING THE Christmas season, McDonald's came out with a big promotion: buy a $2.25 Big Mac and get a specially packaged videotape of *Dances with Wolves* for just $7.99. The promotion was a hit with McDonald's customers, but not with most video retailing stores. Orion Pictures, which owns the 1990 Oscar-winning movie, was charging the vid-



Everett Collection

Scene from "Dances with Wolves"

Did Trans World make a meal of it?

eo stores an estimated $79 per copy for the same version of the movie (minus the packaging) and recommending that they sell it for $99.

But Albany, N.Y.-based Trans World Music Corp. (estimated 1992 sales, $455 million) didn't complain. It has been selling the made-for-McDonald's version of *Dances* in its Coconuts, Record Town and Saturday Matinee video chains. Trans World's price: $14.99. It has sold thousands of these *Dances* tapes.

The buzz in the video retailing business is that Trans World's store managers must have eaten lots of Big Macs and then loaded up on *Dances* tapes. McDonald's had neglected to limit its offer to one *Dances* per customer. Even including the price of the burger in the video's cost, the retail markup would come to nearly 50%.

Jeffrey Jones, Trans World's chief financial officer, won't confirm the rumors, but he does say, with a verbal wink: "Don't you find it quite clever, creative and entrepreneurial that we would be able to pull off something like this?" —LISA COLEMAN

Slow learner

IS RUSSIA, the former socialist paradise, ready to import a modified brand of socialism from the U.S.? David Kotz, an associate professor of economics at the University of Massachusetts, Amherst, has been in Moscow urging Russians to go back to rigid price controls and central planning. To halt hyperinflation, Kotz says, Russia's parliament should impose a three-month freeze on all wages, prices and exchange rates. After the three months are up, the government should set prices of raw materials and energy, as well as set prices on the output of most medium and large-scale enterprises. Kotz also wants the central government to reassert control over distribution of goods and investment.

"The ideal system [of price controls] would encompass the entire economy," argues Kotz. Kotz may have found an ally in Ruslan Khasbulatov, the powerful speaker of the Russian parliament and foe of free enterprise who has asked Russia's Academy of Sciences to study Kotz's idea. —PAUL KLEBNIKOV

Way to go

SIR: Describing American management as masters of "catchword" techniques like total quality management, just-in-time, and lean manufacturing is generous ("The myth of U.S. manufacturing's decline," *Jan. 18*). While recognition of the need has increased recently, there is still a wide gap between the potential and the reality. In particular, the techniques that work so well on the shop floor need to be moved to the purchasing, design room and accounting departments.
–JIM AYERS
Ingersoll Engineers Inc.
Rockford, Ill.

Reckless game

SIR: "Danger zone" *(Jan. 18)* confirmed many of my worst suspicions about why so many sub-secondary stocks are trading so out of touch with reality. If I wanted to engineer a scenario which would cause the public to demand a significant curtailment of free markets, I could think of no better plan than to let these games go on and let nature take its course for a few years.
–THOMAS J. LEWIS
Mendham, N.J.

Frivolous suits

SIR: Re "Shoot the hostages" *(Dec. 21, 1992)*. Lawyers file frivolous suits because they know defendants will settle for an amount slightly less than what it would cost to fight the suit and win. It's a form of legal blackmail.
–PAUL SACK
San Francisco, Calif.

SIR: Rule 11 does not (in our world) serve to inhibit plaintiffs at all. Most plaintiffs asserting frivolous cases (if there is such a thing anymore) are "judgment proof." In theory, Rule 11 deters frivolous litigation. In practice, it increases the risk of advancing meritorious defenses.
–JACK W. WESTALL JR.
Asheville, N.C.

Binding ties

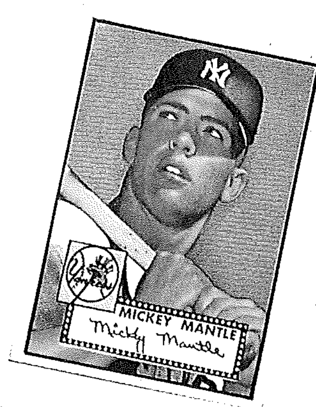
SIR: That Southern California Edison and Pacific Gas & Electric want to be sure they are not being overbilled is both normal and legal, and is not evidence that the utilities are trying to get out of their commitments. They are not ("Power plays," *Dec. 21, 1992*). The commitments on the part of the utilities to buy nonutility power are legally valid contracts between the suppliers and the utility purchasers. The utilities are entitled to be made whole if the contracts—or relevant regulations—have been violated. But this in no way represents any concerted attempt on the part of the utilities cited to break these contracts or to avoid future purchase of nonutility power.
–STEVEN D. BURTON
Chair
National Independent Energy Producers
Washington, D.C.

For the common good

SIR: Re "You haven't seen anything yet" *(Nov. 23, 1992)*. The European commission's policy is to march in step with public opinion and to encourage citizens and businesses to see the benefits of greater cooperation rather than impose rules from on high. Through the creation of the single European market, the commission, far from intervening in business, is helping to create a far freer trading system than has existed in Europe before.
–BRUNO DETHOMAS
Spokesman
Commission of the European Communities
Brussels, Belgium

Die-hard fan

SIR: I thought FORBES had just shorted the entire baseball card market ("Honus Wagner strikes out," *Jan. 4*). There's is a lot of junk product in the collectible-market place, and there will always be excess hype surrounding anything profitable. However, recent pullbacks in quality card prices are a buying opportunity for those of us who have favorite players and still love our national pastime.
–ANTON J. KOACH
DeKalb, Ill.



A 1952 Topps Mickey Mantle card
Always a winner.

Larry Fleming

Hats off

SIR: Re Follow-Through *(Dec. 21, 1992)*. When you shout, "Did he get taken this time?" as you did about Primerica's Sandy Weill on your Apr. 15, 1991 cover, then "follow through," as you did in your Dec. 21, 1992 issue, in a comparative whisper that well, no, he didn't, then don't you agree that congratulations are forthcoming from FORBES?
–HOWARD PEAK
Kalamazoo, Mich.

We do.–ED.

Coupon rate

SIR: Harvard's 5½s of 2015 are trading below par ("Hold that rating," *Nov. 23, 1992*).
–ROBERT L. CHRISTENSEN
Chappaqua, N.Y.

Long overdue

SIR: The real question of principle is why a democratic government in Hong Kong is required now, if not long ago under British rule *(Fact and Comment, Jan. 4)*. Mr. Patten is practicing the ultimate form of hypocrisy with China.
–DAVID L. RAMSOUR
Senior Vice President
& Chief Economist
Bank of Hawaii
Honolulu, Hawaii

Bushonomics

SIR: Re "Tax strategies for Clintonomics" *(Dec. 7, 1992)*. My only regret of Clinton's victory is missing a FORBES "Guide to Bush's tax hikes," a necessary step after twelve years of "borrow and spend" economics.
–CRAIG A. JACOBSON
New York, N.Y.

Now there's an air suspension system for every size budget.

The very technology that created a revolution in running shoes is now creating one in Range Rovers.

It's called air suspension.

And beneath the rugged chassis and opulent interior of the 1993 Range Rover County LWB, you'll find it doing things coil spring suspensions just can't do.

Like monitoring the vehicle's height 100 times per second. Muting road and cabin noise to substantially lower levels. Providing a smoother ride on a variety of surfaces. As well as five different height settings to suit a variety of conditions. It can even be lowered enough to make getting in and out easier.

Of course there are also over 80 additional improvements to speak of.

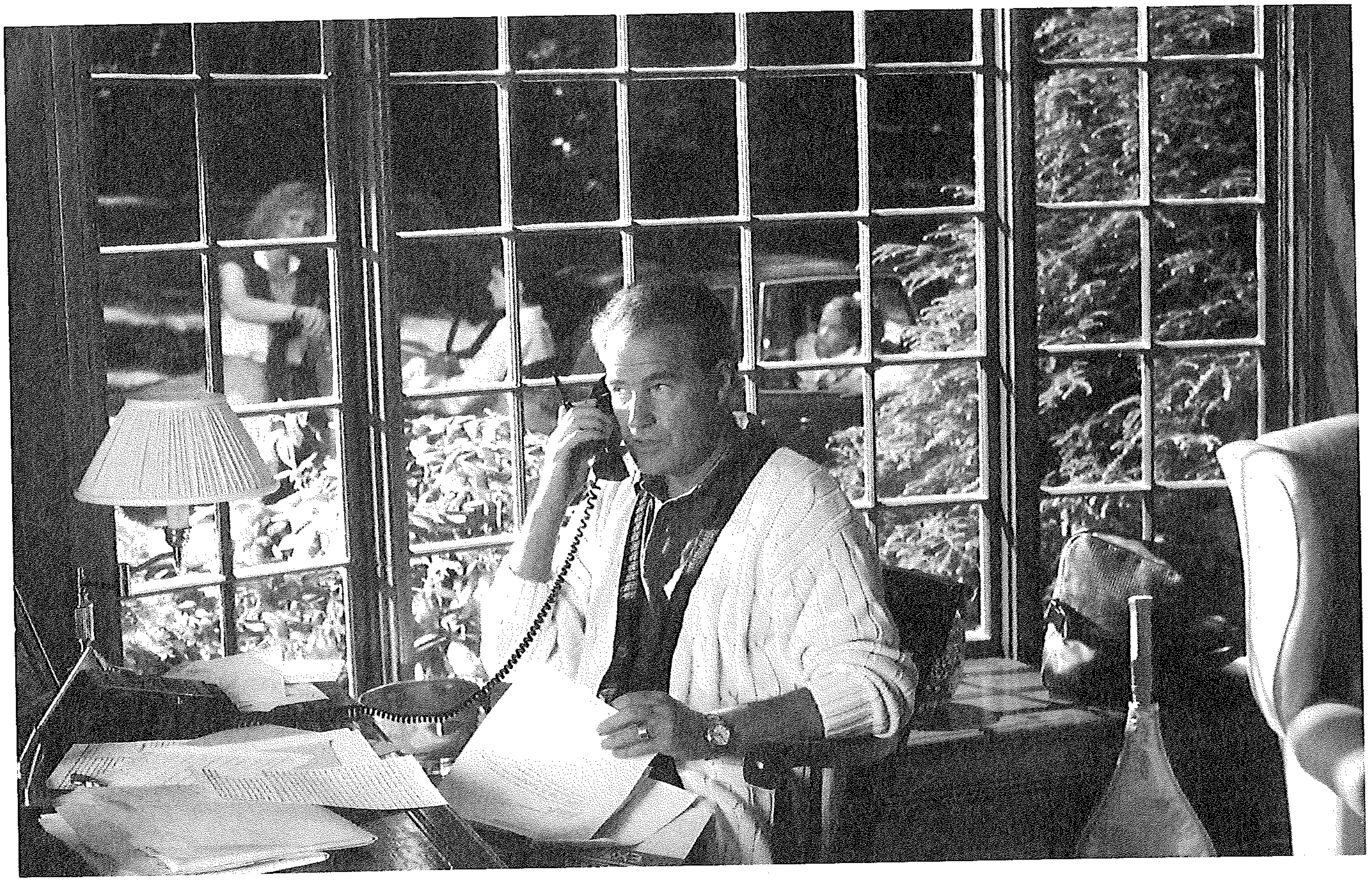
Like a new 4.2 liter V-8 engine. Electronic traction control. And a 108" wheelbase that makes this the roomiest Range Rover ever built.

Why not try one on for size by calling 1-800-FINE 4WD for the nearest dealer?

Granted, these new County LWBs are hardly inexpensive.

But considering how sturdy and comfortable they are, we think you'll end up wanting a pair.

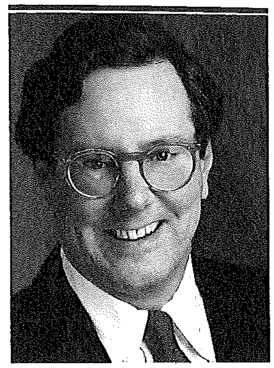
LAND ROVER RANGE ROVER



"With all thy getting get understanding"

Fact and Comment

By Malcolm S. Forbes Jr., *Editor-in-Chief*



BOSNIA—CLINTON'S TRUMANESQUE TEST

A MORE IMPORTANT test for us in the post-Cold War world than Iraq is the former Yugoslavia.

Harry Truman decisively established our commitment to contain Soviet communism by refusing to abandon West Berlin in 1948 when Stalin cut off the U.S., British and French sectors of that city from their lifelines to the West. We faced a terrible choice: risk war by trying forcibly to reopen roads to the city or give up West Berlin to the Soviet dictator. Truman ignored advice to abandon Berlin. The U.S. initiated a massive airlift that kept the city alive with food and supplies. Stalin eventually lifted the blockade.

UPI/Bettmann

Christopher Morris/Black Star

Berlin and Bosnia: Testing U.S. stamina to make the world safe for democracy.

The crisis galvanized the West into creating the North American Treaty Organization, demonstrating that the forces of evil would not win the West.

Bosnia is the moral equivalent of the 1948-49 Berlin blockade. Through selected bombing and by arming the victims of Serbian aggression, the U.S. could show Europe that the forces of murderous nationalism can be curbed. The threat of a wider war would recede, and the social fabric of Western Europe would not be strained by the unwanted inflow of countless refugees.

People would be reassured that this new era will not be bloodily pockmarked by regional wars and terrorism, that the U.S. is willing to play the role that only it can play—as the active, guiding force for good in a world that would otherwise revert to age-old habits of conflict and conquest.

GIVE HER A REAL JOB

PRESIDENT CLINTON SHOULD take a cue from his hero John Kennedy and appoint Hillary to the Cabinet or to head up a federal agency. Such a move would be no more shocking than JFK's naming his 35-year-old brother attorney general. It would cut off the inevitable accusations of her manipulating the President and his Administration.

Her chairing an ad hoc panel on health doesn't do the trick. A statutory post would allow Mrs. Clinton's abilities and policies to be judged in public like other government officials'. She would have the standing and legitimacy to offer the President influential advice on everything else, just as Harry Hopkins did for FDR, Bobby Kennedy did for JFK and Jim Baker did for George Bush.

The law barring a president from naming close relatives to government posts (LBJ's slap at Robert Kennedy) should be repealed immediately.

MISREADING THE MARSHALL PLAN

BONN'S ECONOMIC mishandling of reunification with eastern Germany has thrown the Federal Republic into a recession, greatly damaged the economies of neighboring nations and now poses a stark example of how not to help Eastern Europe and the former Soviet Union.

Will the new Administration and Western Europe learn the right lesson? If not, President Clinton is in for much unnecessary foreign policy trouble, and the economies of Europe and America will pay the price.

With East Germany, the Kohl government thought it could repeat the rapid economic resurrection that West Germany experienced from the rubble of WWII. Bonn remembered that the Marshall Plan had pumped in a lot of money and that by the early 1950s Europe's industrial output had easily topped prewar records. But the success of the Marshall Plan came not from the considerable amount of money shipped over to Europe. Rather, it grew from the impetus the plan gave to currency reform and to economic liberalization, such as lowering trade barriers.

The real hero of the West Germans' impressive postwar economy was the country's finance minister, Ludwig Erhard. In 1948-49 his currency reform made West

German money valuable, stopping inflation dead in its tracks. He swept away many debilitating regulations. His frequent tax cuts spurred the creation of numerous new businesses.

Britain, France and other countries received more money per capita than West Germany, but their economies did not do nearly as well. (Japan's economic rocket didn't take off until after the U.S. had virtually cut off economic aid there. Nor did South Korea and Taiwan begin their impressive success stories until our aid was shut off.)

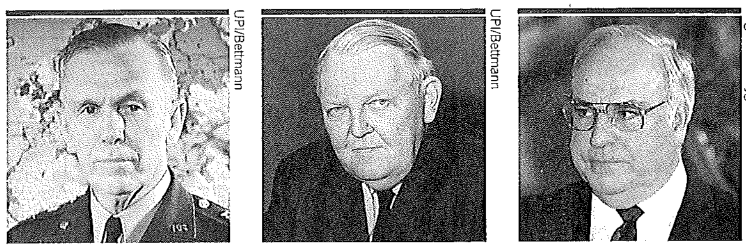
Inspired by a faulty memory of the Marshall Plan, Germany is spending tens of billions of dollars in the east, but this time there is no miracle. Why?

The German economy is riddled with rigid regulations. Erhard is long gone, and taxes are now high. Labor laws are tough. New business formations are low for a country of such wealth. This whole high-tax-cum-elaborate-welfare apparatus was imposed on the east. Without massive subsidies from Bonn, unemployment in eastern Germany would be over 30%. Following the spirit of Erhard, the east should have been largely exempt from all of those rules and levies.

Given its economic hardening of the arteries, Bonn's massive spending has triggered higher prices. Its stiffer taxes have stagnated the economy. The Bundesbank compounded these errors by boosting real interest rates to bone-crushing levels in the name of fighting inflation.

The much ballyhooed agreement among Germany's political parties to cut sacred social spending programs a bit won't overcome Bonn's fundamental mistakes, particularly as taxes are scheduled to go up even more in 1995.

No wonder Europe has tumbled into recesssion. No wonder voters there are frightened and resentful.



UPI/Bettmann UPI/Bettmann Regis Bossu/Sygma

Marshall, Erhard, Kohl: It was Erhard's spirit of enterprise more than Marshall's money that propelled West Germany's postwar economy.

THE MORAL OF THE EAST GERMAN MORASS

is clear. Pouring money into Russia and her neighbors won't work. The Clinton Administration should look again at what made possible Western Europe's and Japan's rapid post-World War II recoveries.

Currency reform. Real money is the first essential for prosperity. Thanks to the Bretton Woods international monetary system, the European Payments Union and other measures, Europe quickly achieved this goal. West Germany, Italy, Japan and others didn't begin booming until their monies were sound. Yet the U.S. and its industrial allies have made no sensible monetary proposals to Moscow.

Taxes. West Germany began systematically reducing its high, wartime taxation in the late 1940s. Its economy quickly responded. Japan enacted major tax cuts in the mid-1950s and didn't suffer a recession for more than 35 years. Britain kept its levies high and became a laggard. Today Russia torments entrepreneurs with horrific taxes. Western experts have largely turned a blind eye.

Human capital. Communism crushed it, not only by barring free enterprise but also by perverting the human spirit with a system based on lying and cheating. We haven't done enough to emphasize the necessity of a legal system where the law is not the whimsical creature of those in power, where written private contracts are enforceable and where property and personal rights are protected.

Rome wasn't rebuilt in a day. Dismantling or privatizing state companies and eliminating the web of price controls don't have to be achieved overnight. Removing regulatory obstacles for starting new businesses and rubbing out rules that protect existing state-owned ones would suffice in successfully encouraging a more free-enterprise-oriented economy.

Trade. A critical component of the boom of the Fifties and Sixties was the extraordinary expansion of trade and international flows of capital. We can do far more to help create a free-trade area in Eastern Europe and Russia and tie it to us and to Western Europe, thereby fostering political forces whose values coincide with our own.

RESTAURANTS—GO, [illegible], STOP

Here is the distilled wisdom of brothers Bob, Kip and Tim, and other FORBES *eatery experts Jeff Cunningham and Tom Jones.*

Sardi's—234 West 44th St. (Tel: 221-8440). Once celebrated but then disdained, Sardi's is again a place that can easily be recommended to anyone wanting a pleasant meal in the theater district.

Manhattan Cafe—1161 First Ave., near 64th St. (Tel: 888-6556). Big, attractive, club-like. Porterhouse and sirloin, first-rate. Smoked salmon with asparagus in a light vinaigrette, an unusual and delightful combination. Waiters, old-fashioned professionals who know their clientele, menu and wine list.

Seryna—11 East 53rd St. (Tel: 980-9393). Service could top anybody's list of the slowest in town. Much touted cooking on a rock at the table invariably makes the restaurant smoky, and your clothes are apt to remember the meal longer than you do.

Mesa Grill—102 Fifth Ave., near 16th St. (Tel: 807-7400). Zippy, original and incredibly noisy. Service slightly erratic. The menu includes the most imaginative southwestern-inspired food in town. Particulary noteworthy are blue corn pancakes with tequila-smoked salmon, mango crème fraîche and caviar.

I Tre Merli—463 West Broadway (Tel: 254-8699). Atmosphere is go-go, location is SoHo, food is uh-oh, the experience is no-go.

Chin Chin—216 East 49th St. (Tel: 888-4555). Outstanding Chinese cuisine even though the place looks anything but Chinese. The dumpling assortment is as good as any we've had.

aluminum. But a reliable engine that could survive the kinds of real-life tests other engines couldn't.

Which, in our opinion, makes those five long years of research and development well worth the effort.

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And when you combine that with the kind of chassis, suspension and steering system Motor Trend magazine has deemed "tight, responsive, and confidence-inspiring," the idea of building a car around a driver starts to sound quite compelling.

Of course, this philosophy extends to the entire driver's environment. So the 740i is endowed with everything from driver and passenger-side airbags to all the gathered Nappa leather, burnished walnut and other creature comforts you would expect to find in a leading luxury car.

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Other Comments

Let's Hope It's an Omen

BILL CLINTON'S third grade teacher, Msgr. John O'Donnell, claims, "I aroused young Bill Clinton's interest in world history and politics when I taught my course in the Decline and Fall of the Roman Empire." He also recalls, "At the end of the course, Little Willy stood up and said that if he had been emperor, Rome wouldn't have fallen."
–DR. EDWARD YARDENI,
chief economist, C.J. Lawrence

Stand and Deliver

CYRUS VANCE, co-chairman of a Geneva conference on the Bosnia conflict, asked Secretary of State Eagleburger not to meet the President of Bosnia, who [was] visiting the U.S. Here is the president of a small country that has been cruelly attacked, 100,000 of its people killed, 1.5 million driven from their homes, thousands of women raped. And American officials should refuse to meet him?

The Bosnian Muslims, victims of Serbian aggression, are essentially being pressed to accept the results of the aggression, thinly disguised as a political solution. Even if the Bosnian parties accept Vance's [peace] draft, it will be meaningless unless the West is prepared to enforce the terms. And that means American leadership.

The responsibility will be Bill Clinton's. [He must] make clear to the Serbs that if they do not end their siege of Sarajevo and other military attacks, he will use force. Appeasing aggression exacts too terrible a price.
–ANTHONY LEWIS, *New York Times*

The science of politics is self-delusion.
–PRESIDENT JIMMY CARTER,
on National Public Radio's *Fresh Air with Terry Gross*

This Could Save Your Life

JUST OVER A YEAR AGO I underwent surgery to remove my cancerous prostate gland. Since my operation, an estimated 34,000 men have died of prostate cancer. It is the most common form of cancer among men, exceeded only by lung cancer. Statistically, prostate cancer will afflict 1 out of every 11 American males, and 1 out of every 3 men over the age of 50.

With recent advances in diagnostic and treatment techniques, early detection—and successful treatment—are becoming more and more common. Prostate problems can be detected with the standard digital rectal exam, with ultrasound testing, with the PSA blood test or with a combination of these tests, including a biopsy.

As a public figure and a prostate cancer survivor, I feel an obligation to alert men to the value of early detection. Sharing my experience with others—as uncomfortable as it may sometimes be—has been a small price to pay knowing that it may help a man, a father, a husband or a brother.
–SENATOR BOB DOLE (R–Kan.),
Washington Post

Hair, Hair

I AM EVEN a little conservative. If someone had a bald spot 20 years ago, I would like him to have that same bald spot now.
–VACLAV HAVEL, *Time*

Mad Hatters

THE TROUBLE WITH our Ambassadors in stations of real importance is that they totally fail to give real information, and seem to think that the real life work of an Ambassador is a kind of glorified pink tea party.
–THEODORE ROOSEVELT, quoted in *Theodore Roosevelt: A Life*, by Nathan Miller

"Nothing personal, Pooh, but we figured you'd fetch a fortune on the open market."

Painting the Town Red

MOSCOW AT NIGHT is like Chicago during the Depression. The men cruise around like swells and the women play at being molls. Already there are legendary moguls: the fellow who shows up in nightclubs in a white sharkskin suit; the fat man who sits in the lobby of the Metropole ostentatiously making calls on his cellular phone.

Communism is dead and Russian businessmen seem to have hit puberty. One rarely sees Volkswagens in Moscow, but there is a Mercedes at every stoplight. There are two parallel Moscows now, the red ruble Moscow of shortages and queues and the green dollar Moscow of high octane gasoline and cellular phones.
–DAVID BROOKS,
Wall Street Journal

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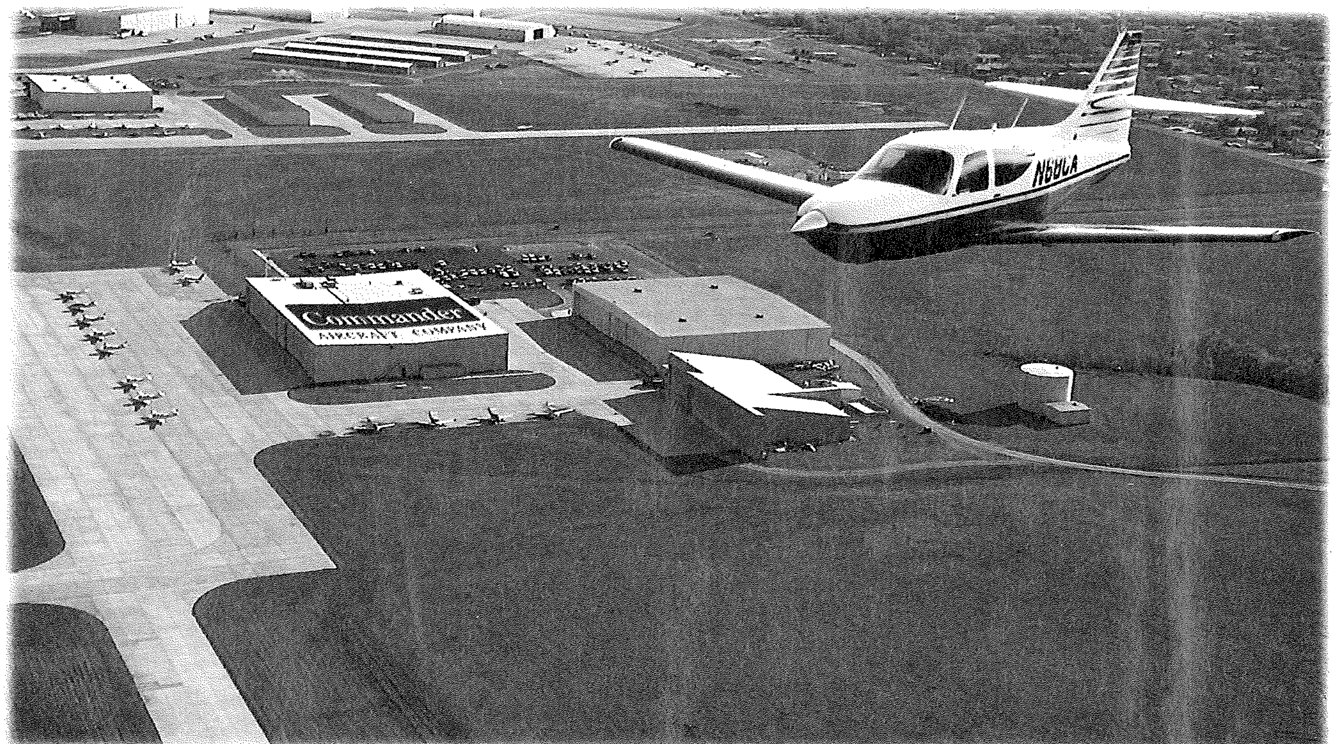

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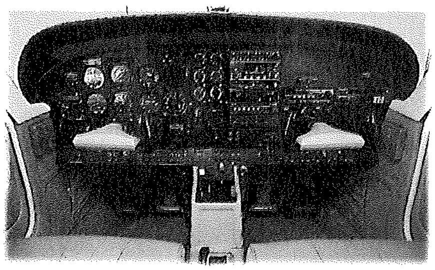

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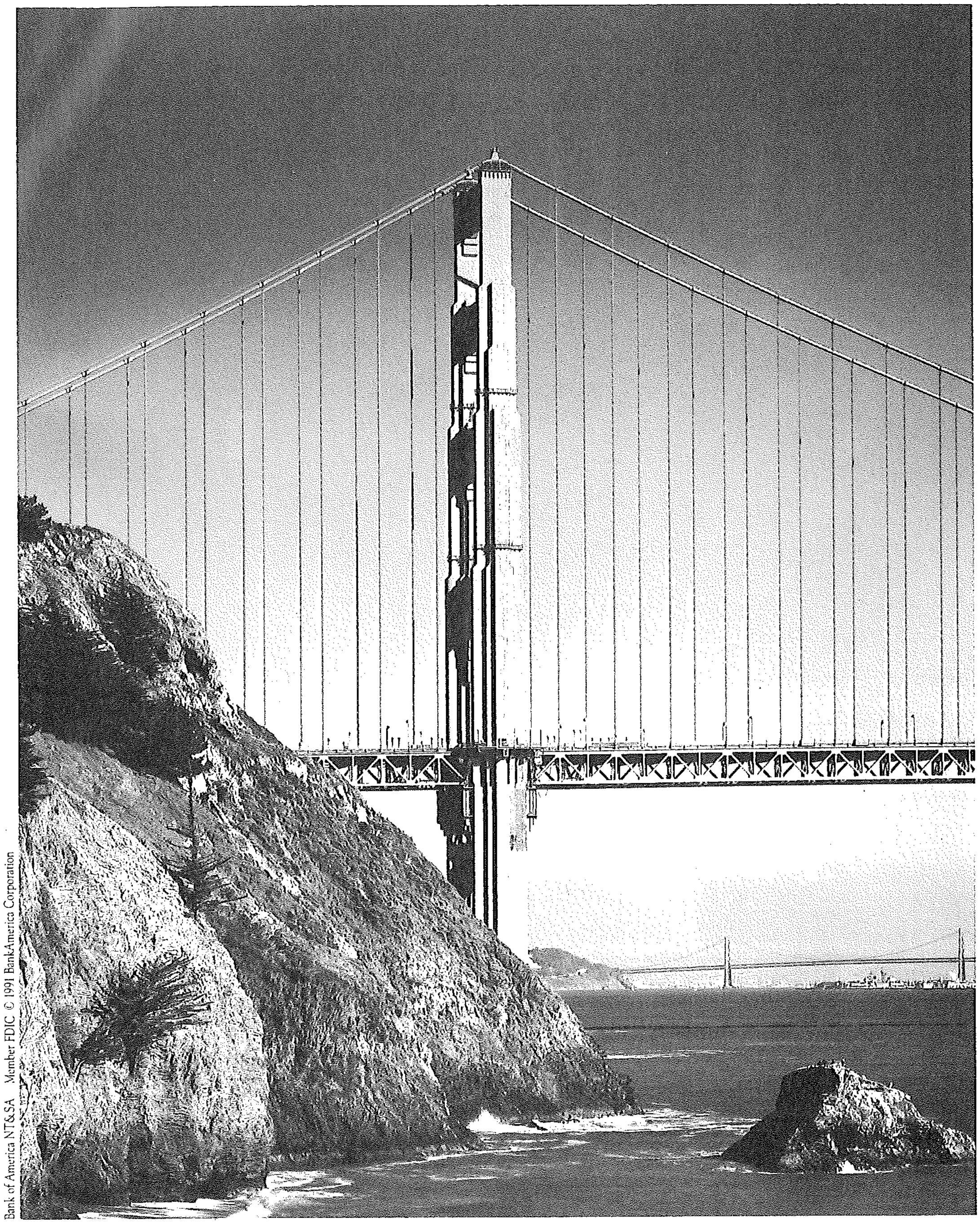
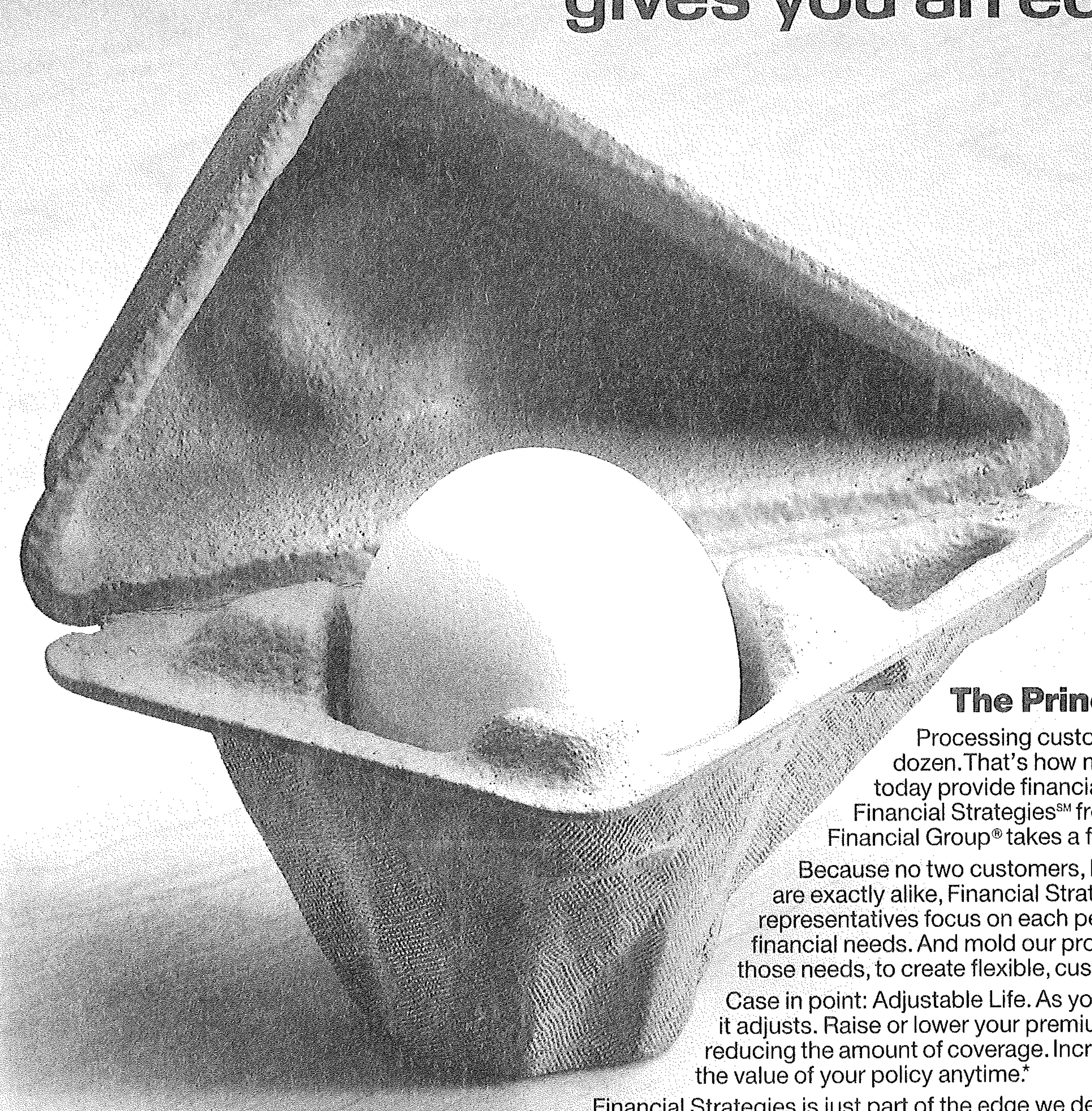
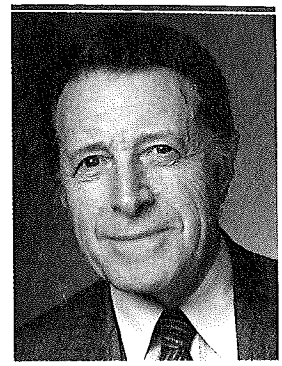




Commentary

on events at home and abroad

By Caspar W. Weinberger, *Publisher*



THE NEW WORLD ORDER—DEFINED

THE PROBLEMS involving Saddam Hussein, a new world order and a world police force are all inextricably intertwined. Much of the discussion of the U.S./British/French air attacks against Hussein's missiles seems to overlook that linkage.

When in 1991 the U.S. destroyed the bulk of Saddam's military capability after he took Kuwait and threatened to invade Saudi Arabia and the United Arab Emirates, it was acting in concert with some 30 allied nations to give bone and sinew to an otherwise unenforceable U.N. resolution. To use President Bush's visionary phrase, we did that to create a "new world order." The usual carping critics of everything we do and don't do immediately responded with their normal skepticism, inquiring as to the "real definition" and other dimensions of a new world order.

Their skepticism and cynicism were quite unfounded. A new world order is a noble and vitally necessary condition for the future. Quite simply, it means that the U.S. and other democratic nations agree to be governed by a rule of law whereby any country breaking that law is treated much as criminals are in each country: They are tried and, if found guilty, punished. The process will be carried out in the same manner that police and courts enforce local laws.

Applying this on a world scale means that we could gain what we had hoped the U.N. would achieve but has not: global law, breaches of which will be punished swiftly and with certainty. In the case of Desert Storm and Iraq, global law was established by the U.N., which condemned Iraq's brutal actions and its attempts to control nearly 60% of the world's known oil reserves.

Theory Put into Action

There is not a shadow of a doubt that both Saddam's invasion of Kuwait and his threats of further lawbreaking required punishment designed to convince him that violations of the law cannot be committed with impunity. He committed crimes against humanity and nature when, without provocation or warning, he sent his tanks and troops into a small neighboring country that had poured out billions of dollars to help him in his war with Iran.

Without the goal of a new world order that President Bush acted to achieve, we would have had the usual number of U.N. resolutions, some futile negotiations and, ultimately, some feeble compromises that would probably have left Saddam Hussein in control of the Kuwaiti oilfields. Instead, the U.S. fulfilled the responsibilities that our resources and our strength have given us—leading a 30-nation coalition that destroyed Saddam Hussein's air power and the vast majority of his total military capability.

As a parting blow that reminded us what a remorseless criminal he was, Hussein, on his way out of Kuwait, set fire to the country's oilfields, threatening major environmental damage and causing huge losses of vital resources. Again the U.S. and its allies provided the expertise that put out these fires two years ahead of schedule, saving the world from yet another disaster.

Needs of Many Outweigh Criticism from Few

It is all well and good for supercilious critics and writers interested in finding something wrong with every action the U.S. takes to criticize it for "trying to be the world's policeman" and "trying to impose a Pax Americana" on the rest of the world. But these anemic and academic critics would have been the first to criticize if they had had to wait hours in line for the privilege of paying a grossly inflated gasoline price to a victorious Iraq.

So in the closing days of President Bush's Administration, it was entirely necessary and appropriate for the President to initiate similar action, joined this time by Saudi Arabia, which let us use its airfields, Britain and France. First with 110 allied aircraft and later with additional air attacks, we have reminded Saddam Hussein that he is still under severe restraint and will remain so as a result of his many criminal acts.

Military action should always be a last resort, just as punishment is a last resort of local law enforcement. And, in each of these actions made necessary by global law violations, it is essential that as many freedom-loving nations as possible participate, just as one city's fire department does not ignore a fire in another city when the fire-fighting resources of that city are incapable of putting out the blaze.

The rule of law carries with it great responsibilities, but the benefits of acting, and the huge risks of *not* acting to prevent or punish global crimes are so enormous that the price demanded of us in keeping world peace is well worth it.

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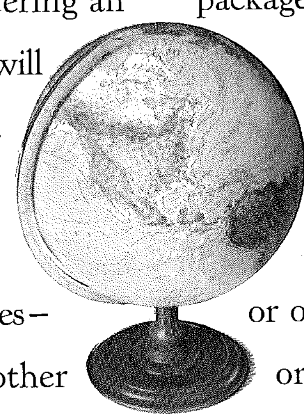

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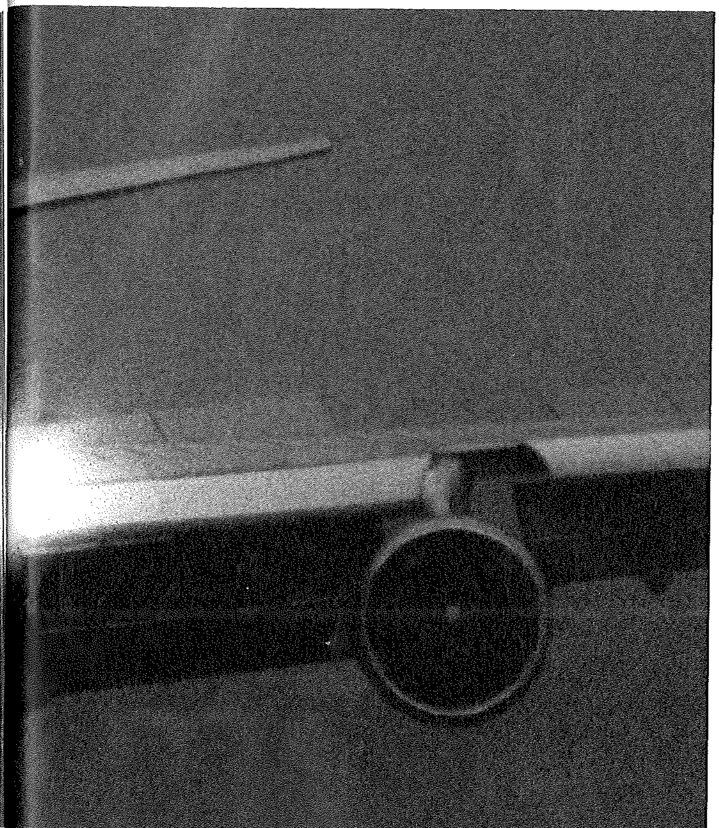

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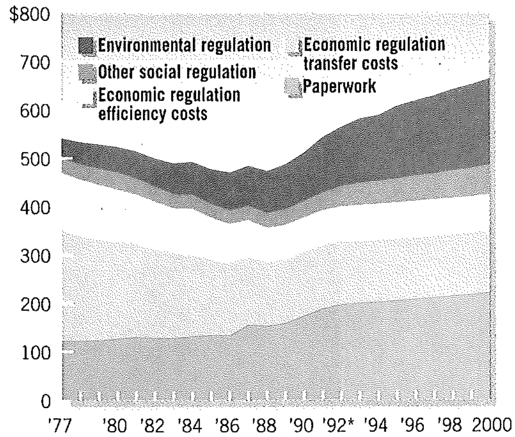
Tomorrow, we'd like you to pick UPS.

The cost of the feds' ketchup and other rules

CONSERVATIVELY MEASURED, the cost of federal regulations came to $542 billion in 1992, or just over 9% of gross domestic product. The trend is definitely up, up and away. Laws already on the books mean the cost will hit at least $662 billion (in 1991 dollars) by 2000, says Thomas D. Hopkins, the Arthur J. Gosnell professor of economics at Rochester Institute of Technology, who made these calculations. In 1986, Hopkins adds, the bill was $469 billion.

Regulatory ratchet

Annualized regulatory costs (1991 dollars, $billions)



*Data after 1992 are estimates.

Source: Thomas D. Hopkins, Rochester Institute of Technology

Having dipped in the mid-1980s, thanks to deregulation in 1977 to 1982, the cost of federal regulations is rising fast. The likely trend is for it to rise faster still.

Hopkins says that he is not including the many billions more that arise from state and local government regulations. Nor does he include the indirect costs of regulation—for example, the depressing impact on productivity and investment, or misallocation of resources.

These indirect costs are much more difficult to calculate, but they exist and they are monstrous. In just one specific corner of regulation, affirmative action, FORBES estimates that the total cost, direct and indirect, now comes to over $110 billion a year *(see story, p. 80)*.

Congress is increasingly turning away from spending programs (which are now difficult to finance) and towards passing mandates and regulations, where the cost is hidden. Hopkins reckons federal regulations now cost each household about $5,700 a year.

How so? Hopkins divides the mass of federal regulations into five areas:

- Environmental laws, such as clean air and water controls. The annual cost of these, says Hopkins, "could easily be half as high again" as his estimate of $122 billion. The cost of the clean air amendments passed in 1990 will continue to ratchet up after 2000.
- Social regulation, which includes health and safety, plus such open-ended items as affirmative action and the Americans with Disabilities Act, where nobody yet knows just how enormous the cost will be.
- Economic regulation costs come in two parts. Direct regulation has declined since the late 1970s' deregulation of airlines, trucking and communications. Indirect regulation, which transfers costs from producers to consumers, includes such items as "voluntary" controls over the imports of textiles and autos, or price controls over sugar. Entrenched pressure groups make it hard to eliminate these items.

As an example of some of the sillier rules that have been embedded in the nation's book of regulations, Hopkins points to the ketchup rules enforced by the agriculture department. These rules require producers to monitor how runny their ketchup is at least once an hour.

- Paperwork, by far the fastest-rising category of federal regulation, now takes up an estimated 6 billion hours of private-sector work time every year, mostly to comply with the tax laws. (It's idle speculation, but might failed Attorney General candidate Zoë Baird have paid the taxes if doing so hadn't required filling in dozens of forms, state as well as federal, quarter by quarter and at year-end?)

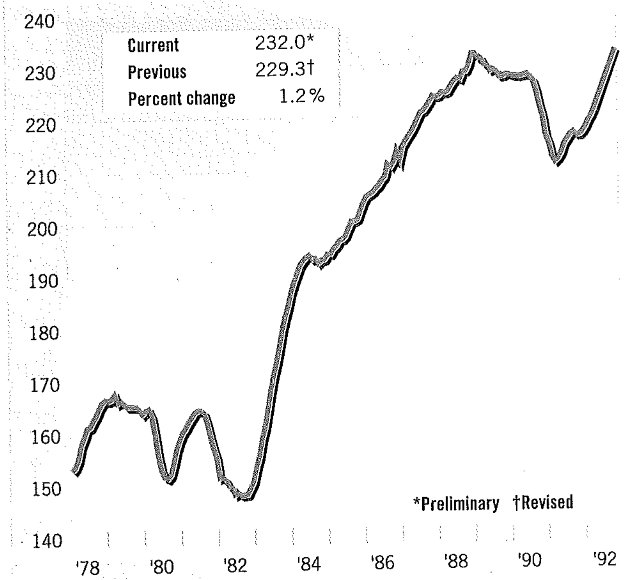
Needed: a cost-benefit approach to regulations

It is a safe bet that the cost will only get worse. On paperwork, for instance, the Clinton Administration promptly scrubbed the Bush Competitiveness Council, which was supposed to restrict useless government paper.

More ominously, the Clinton Administration, aided and abetted by an activist Congress, is already moving to add more costs to the U.S. economy through new regulations. Family leave is but the first of many new regulations. Perhaps the most expensive will be whatever emerges from First Lady Hillary Clinton's task force on health care.

Are all regulations bad? Of course not. Up to a point, they are part of the price one pays to live in a civilized society. Obviously there have to be some rules that prevent foodstuffs from containing poisons, or that weed out drugs that harm more than they help. The problem is that nobody in government ever asks if the regulations they pass produce sufficient benefits to justify the megabillions they cost.

The Forbes Index (1967=100)



A few components have yet to be reported, so it may be too soon to celebrate, but the Forbes Index—with a 1.2% gain in December—is currently showing its biggest increase in almost six years. One factor behind the jump was the improvement in home building. The trailing 12-month total of housing starts rose 1.2%—to 1.2 million units—from November to December. But keep in mind that government data are often revised. A preliminary 0.4% rise in November retail sales, for example, was subsequently reported as a drop of 0.5%.

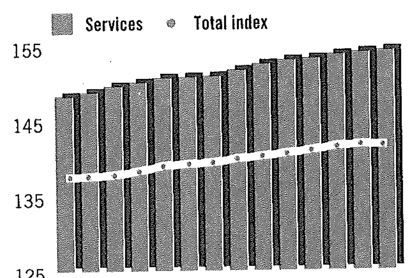
Other key rates	Source	Status
Prime rate	Chase Manhattan Bank	6.0%
Auto sales year to date vs 1992[1]	Ward's Automotive	–16.4%
Index of leading indicators Nov vs Oct	Dept of Commerce	0.8%
Trade balance 12 months ended Nov 1992	Dept of Commerce	–$81bil
All-commodity producer price index Dec vs Nov[2]	Dept of Labor	–0.2%
GDP 3rd quarter vs 2nd—annualized growth	Dept of Commerce	3.4%
M2 (3-month change)—annualized growth[3]	Federal Reserve	3.1%

[1] U.S.-based manufacturers, excludes imports, as of 1/10/93. [2] Wholesale goods. [3] Includes M1 (public currency and checking deposits) plus savings accounts and money market funds.

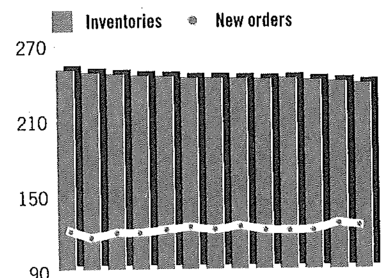
Index components

The Forbes Index is a measure of U.S. economic activity composed of 8 equally weighted elements: The cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total industrial production, new housing starts, personal income, new claims for unemployment compensation, total retail sales, total consumer installment credit.

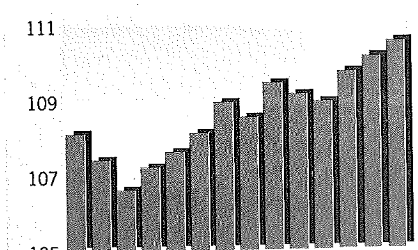
To measure these 8 elements, FORBES monitors 10 series of U.S. government data. The last 14 months' data for each series are presented below.



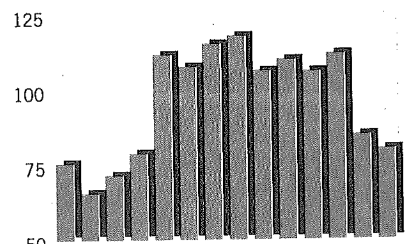
Consumer price indexes (1982-84 average=100) all urban consumers, unadjusted (Dept of Labor)



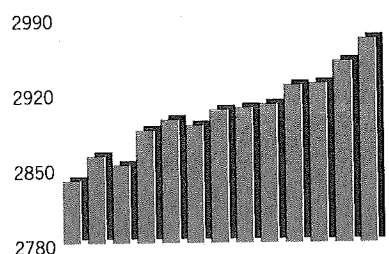
Manufacturers' new orders and inventories ($billions), seasonally adjusted (Dept of Commerce)



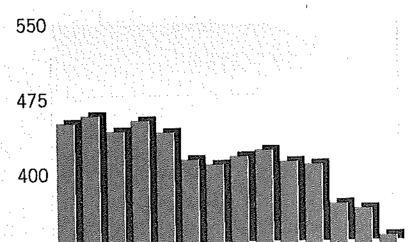
Industrial production index (1987=100) seasonally adjusted (Federal Reserve)



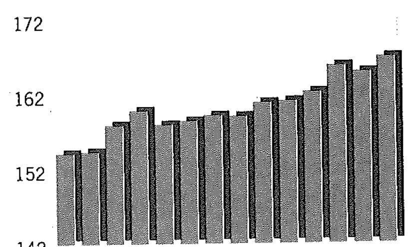
New housing starts (thousands) privately owned, unadjusted (Dept of Commerce)



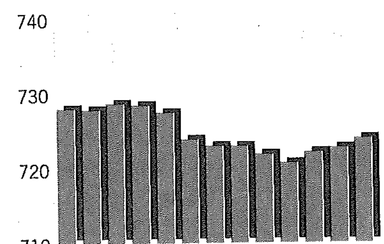
Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept of Commerce)



New unemployment claims average for month (thousands), seasonally adjusted (Dept of Labor)



Retail sales ($billions), seasonally adjusted (Dept of Commerce)



Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

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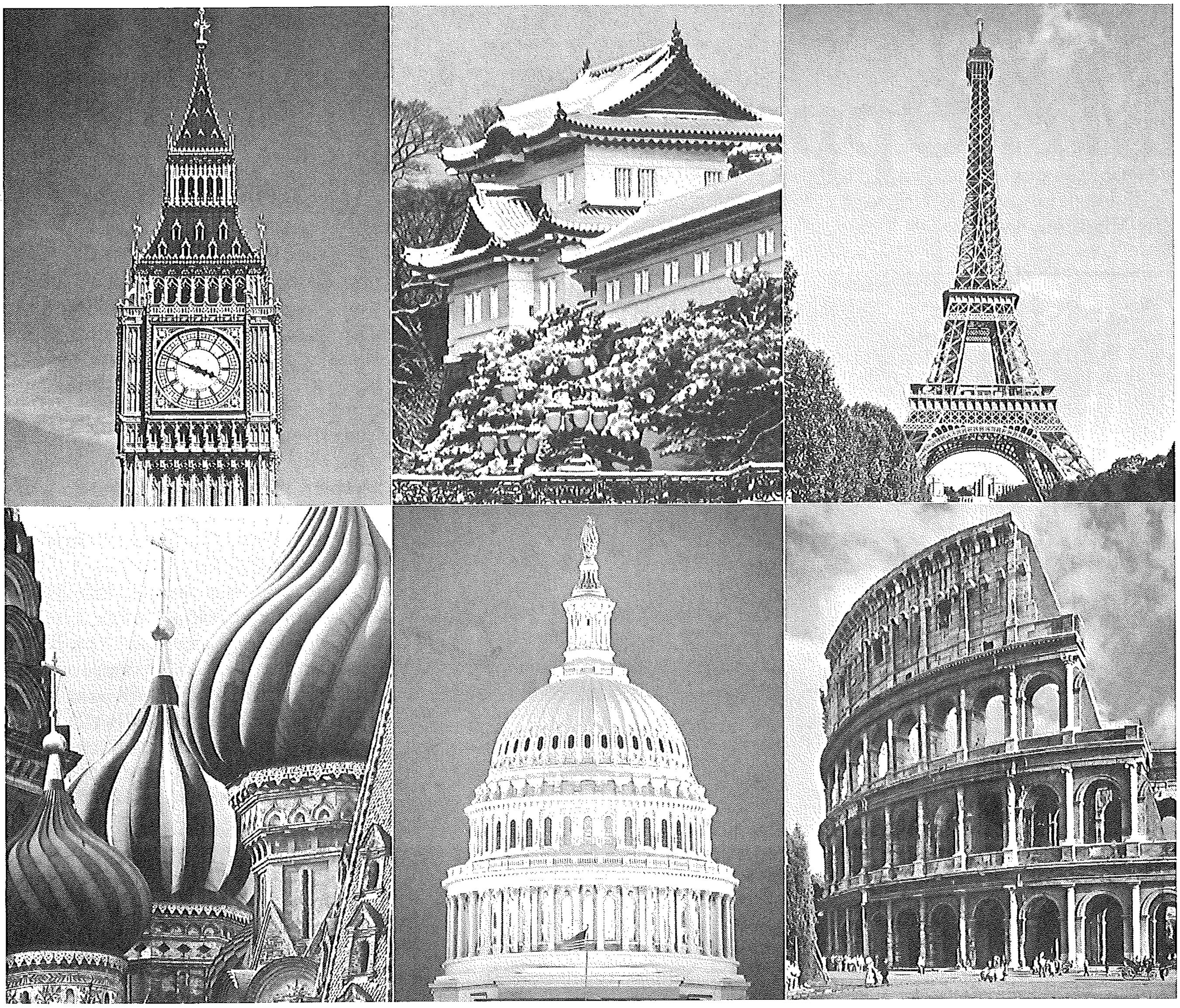

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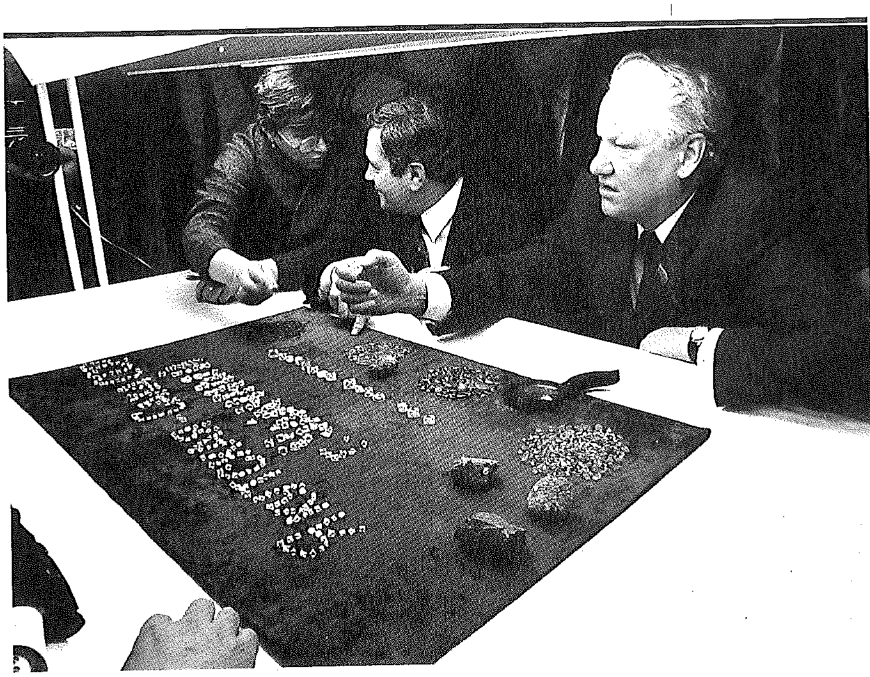
Fairfax County, Virginia. The 21st Century Is Here.

Boris Yeltsin does not consider himself bound to deals made by Mikhail Gorbachev—as Harry Oppenheimer and De Beers are learning.

Sorry, Mr. Oppenheimer

By Vladimir Kvint



URSS/Gamma-Liaison

Boris Yeltsin looks at diamonds in Yakutia

As it begins to sell its biggest diamonds, Russia will need help from Western firms. What will De Beers' role be?

HARRY OPPENHEIMER and his son Nicholas were in Moscow early last September. The Oppenheimers control De Beers Consolidated Mines Ltd. and were there for the opening of De Beers' first Moscow office.

De Beers, South Africa's giant mining company and marketer of diamonds, is the world's largest producer of diamonds. Through its Central Selling Organization cartel, De Beers has long controlled the prices and supply of raw diamonds to cutters and polishers around the world. Russia, the world's second-largest producer of diamonds (after South Africa), is important to De Beers.

According to top Russian officials, the Oppenheimers were scheduled to meet with Boris Yeltsin, the prime minister and other top Russian officials, but at the last minute the appointments were canceled. The snub was apparently deliberate: It was a Russian way of telling De Beers it wanted more money for its diamonds than it had gotten in the past. (De Beers' spokeswoman denies appointments were scheduled but confirms that no top-level meetings took place.)

Not that De Beers needed reminding that it needs the Russians. Angola, one of the world's largest diamond producers, virtually stopped doing business with the Central Selling Organization in the late 1980s. De Beers' operatives have been scrambling to avoid losing the vital Russian diamond production.

In 1990 De Beers signed a five-year deal with Mikhail Gorbachev's government promising De Beers 95% of all Russia's raw diamond production. De Beers agreed to pay \$5 billion over the life of the deal.

But Gorbachev is out, and Boris Yeltsin apparently wants more. Under the Gorbachev agreement, the Russians receive from De Beers an average price of approximately \$68 per carat. Yeltsin figures he can do better. He knows that last year De Beers paid \$205 per carat for uncut diamonds it purchased directly from Yakutia, the eastern Siberian region which accounts for most of Russia's diamond reserves and whose mines produce 98% of Russia's diamonds. The Yakutian diamonds were of higher quality, but not three times better.

Yeltsin has an out. De Beers' 1990 deal cut with Gorbachev says only that Russia must sell 95% of its *uncut* diamonds to De Beers. It says nothing of cut and polished stones. What Russia will probably now do is start cutting and polishing more diamonds rather than delivering them raw to De Beers.

Russia already has several diamond cutting and polishing plants. Three of them—in Smolensk, Moscow and the city of Barnaul, in western Siberia—have modern equipment and experienced cutters. Aware of the possibilities, several small Japanese, Israeli, Dutch and American firms are trying to create joint ventures with the Rus-

sian cutting plants.

If the Russians are playing rough with De Beers, it's because they badly need foreign exchange. With their gold holdings dwindled, diamonds (together with platinum) remain Russia's major quick potential source of more hard currency. Squeezing more money out of De Beers is one way to get it. Adding value through cutting and polishing is another.

From the end of World War II until early 1990, the Soviet Union sold almost no diamonds in the 5-to-10-carat range, and no diamonds larger than 10 carats. When they were found, such treasures were kept in the Russian State Diamond Fund. Worth billions, the trove includes such mammoth stones as the 232-carat "Star of Yakutia" and the 332-carat "XXVI Congress of the CPSU."

As it begins to sell off its big stones, Russia will need to cooperate with Westerners. That's because the market is highly specialized and customers want their diamonds rough or cut and polished to their specifications.

On the prowl for large uncut stones is Maurice Tempelsman. Working out of Paris and New York, Tempelsman lines up a buyer for a large stone, locates the stone in Russia, then gives the Russians the designs for cutting and polishing the stone.

With most uncut stones, however, De Beers is still in control. Last year Yeltsin's government signed an agreement with officials from Yakutia (now Sakha). It says employees and managers of Yakutia's diamond mines and factories will retain ownership of 23% of the proceeds; Sakha/Yakutia's regional government and local authorities get 40%; the Russian government, and government funds, such as the armed forces' social security fund, get 37%. De Beers figures it will end up as marketing agent for all three groups.

To further strengthen ties with the local government, De Beers agreed to help build a diamond cutting plant in Sakha called Polar Star.

Clearly De Beers is doing everything in its power to retain control over Russia's diamond ouput. But that big X in President Yeltsin's appointment book suggests that the Russians are going to be driving increasingly hard bargains.

Why is Robert Bass so eager to buy Macmillan from the Robert Maxwell estate?

Golden books

By Howard Rudnitsky

TEXAS BILLIONAIRE Robert Bass offered $2.1 billion in 1988 for publisher Macmillan Inc. The late Robert Maxwell topped him with an offer of $2.6 billion.

Bass was lucky to lose, because last November he had a second shot at the prize at a much reduced price. With Maxwell's empire in liquidation, a Bass-led group offered $1.2 billion for Macmillan and *Official Airline Guides*. For the latter alone Maxwell had paid $750 million.

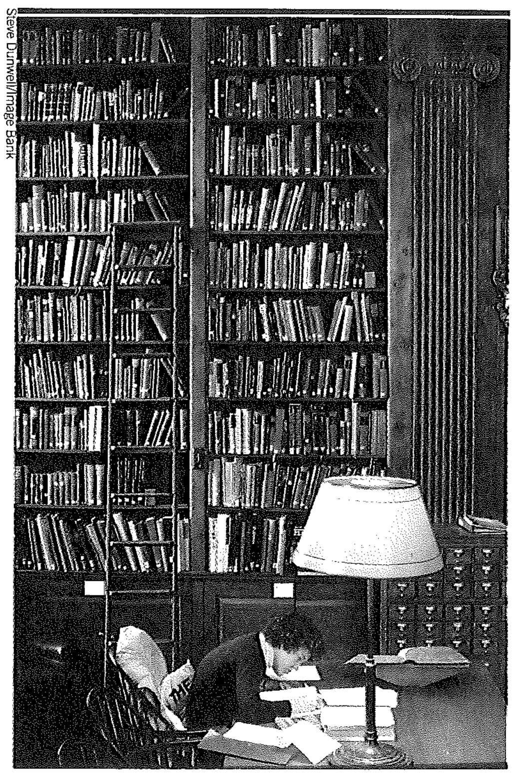
J.P. Morgan & Co., Maxwell Communications Corp.'s receiver, said the offer was too little, but the talks are continuing and there isn't any doubt that Bass and his well-heeled investors, or perhaps another publisher, could buy Macmillan for less than was offered in 1988.

True, Macmillan's business had deteriorated under Maxwell and true, some assets had been sold, but a publishing jewel remains. Macmillan owns 50% of Macmillan/McGraw-Hill School Publishing Co., a $533 million (1991 revenues) elementary through high school textbook publisher, the largest in the country. This joint venture was formed in 1989 from a combination of Macmillan's and McGraw-Hill's elementary and high school book operations. The joint venture reported profits for 1991 of $51 million—nearly 10 cents on the revenue dollar.

Profits for 1992 will rise only modestly, but 1993 should be a lot better. A number of states, including Texas and Florida, will recommend major new textbook purchases. A Texas state committee has recommended that the state legislature approve $280 million worth of book purchases for the school years starting September 1993 and 1994.

Macmillan/McGraw-Hill was among the major publishers whose texts were approved in Texas. Other houses include Silver Burdett & Ginn (Paramount Communications Inc.), Houghton Mifflin, Harcourt Brace Jovanovich (General Cinema Corp.) and ScottForesman (News Corp.).

In 1995 there will be another surge in state purchases of textbooks, including key states like California (12% of all 42 million U.S. elementary through high school enrollments) and Florida.



Steve Dunwell/Image Bank

Student in a Harvard library

A coming baby boomer boost for college texts.

History à la carte

PUBLISHING textbooks may be a profitable business, but it requires constant toadying to the forces of political correctness. Robert Lerner, assistant director of the Center for the Study of Social and Political Change at Smith College, gives an eye-opening example:

By the early 1980s American feminists were complaining loudly that there weren't enough women being adequately depicted in textbooks on the American Revolutionary War. "So they took a woman, Sybil Ludington, who helped warn the Connecticut state militia of an impending British attack on Danbury," says Lerner. As a result, Sybil Ludington became a major figure in the 1985 high school text *America: Its People and Its Values* (Harcourt Brace Jovanovich). Says Lerner: "She is portrayed in the textbook as being as important as Paul Revere. No objective historian believes that."

What historians believe doesn't much matter. Bowing to pressure groups does. Harriet Tubman was an escaped slave active in the pre-Civil War underground railway. Tubman was, by any standard, a real heroine and an important symbol, but modern texts have so inflated her role, says Lerner, that, "In a 1987 study of thousands of 17-year-olds, it was found that far more students knew of Harriet Tubman's role in the Civil War than that Lincoln authored the Emancipation Proclamation."

In 1988 education author Harriet Tyson wrote *A Conspiracy of Good Intentions: America's Textbook Fiasco.* It tells a chilling tale. "California," says Tyson, "has a special [textbook] 'compliance commission' that checks for compliance with all the social issues that are being pursued by special interest groups including feminists, a black power advocate, environmentalists, family values advocates and the like. The compliance commission counted how many female lead characters there are in the textbook, how many blacks and Chicanos appear in pictures, and so on."

If the head counts didn't come out to their liking, the textbook either had to be rewritten or it would be rejected. Call it history à la carte.

A much publicized example concerned Pat Zettner's story, *A Perfect Day for Ice Cream.* Among other things, the original story displeased the nutritionally correct, who decided ice cream is bad for kids. When it was finally published in a textbook for 13-year-olds under the title *A Perfect Day,* the author scarcely recognized the story.

The self-appointed censors come from all corners. The political right objects to anything that might seem even remotely disparaging to religion. The political left is trying to remake American society to some ideal image. Environmental extremists seek to foist a kind of religious pantheism on young minds. In the process, Johnnie's and Jane's education suffers.

—H.R.

For the next few years demographic trends point to a rise in textbook sales in the U.S., where school enrollment will grow 1% a year, compared with 0.8% over the last five years.

Even if Clinton's election doesn't bring additional federal aid to public education, local school budgets are still rising. A recent forecast from Veronis, Suhler & Associates predicts spending on elementary and high school books will grow 5% a year through 1996, to $2.7 billion.

A bit further down the road, in the second half of the 1990s, the $2.7 billion college book market should receive a boost when the offspring of baby boomers flood into college. Successful college books carry high profit margins, what with prices at $35 to $40 or more; who would be so crass as to haggle over price when a college diploma is at stake? And publishers' costs are low on college texts since they often have a single author.

By contrast, large teams of editors, academics and educational bureaucrats are required to produce a major politically correct *(see box)* elementary textbook. It is not unusual for a major elementary text to take four to five years in preparation and to cost over $50 million to launch.

Once successful, a textbook becomes a rich cash cow. The allure of educational publishing led General Cinema's shrewd chairman, Richard Smith, to buy Harcourt Brace in 1991. Smith recently told a group of New York securities analysts that he had spent 30 months looking at consumer goods and services before deciding that book publishing would generate what he wanted: steadily growing high-quality earnings.

Houghton Mifflin, which managed to ward off a hostile takeover attempt in 1989, is one of the few remaining large publicly traded textbook publishing independents. Its 1992 net profits were only $26.8 million before special charges. But its cash flow was recently estimated at $69 million, and it had about $70 million in cash. With $455 million in overall sales, Houghton Mifflin is a prize a large company would love to land, but the company has made it clear it is not for sale.

So now you know why Robert Bass and other bidders are so persistent in the quest for Macmillan.

The soap opera at American Express has been the U.S. business media's equivalent of Princess Di and Prince Charles. But, seriously, can Amex be turned around?

Lots of work to do

By Thomas Jaffe

THE PALACE COUP has ended. James Robinson III still sits, though somewhat uneasily, in the chairman's office at American Express, but with a new and potentially powerful prime minister, Harvey Golub, at his side. So much for personalities. What's next for the company and its shareholders?

For an informed opinion, FORBES went to see Walter Fitzgerald, 58, a longtime follower of American Express, now a money manager and broker at RAS Securities.

Were you surprised the board kept Robinson as chairman and tapped him to run Shearson Lehman?

Fitzgerald: Not really. Somebody has to knock heads together at Shearson. Can Robinson do it? He's certainly Machiavellian enough. As a practical matter, Howard Clark Jr. [Shearson's former chief executive] did not do the job. That's why he's being replaced. It's as simple as that.

What ails American Express?

Shearson. If you adjust Shearson's profits last year by adding back to pretax income the Computervision writeoff, one-time legal expenses and the real estate writedowns, you find that it earned just about 10% on average equity—in a year when it wasn't unusual for securities firms to earn 20% to 30% on average equity. The cost structure at Shearson is completely out of whack with revenues.

Earning 20% on average equity, last year Shearson should have contributed $500 million or $600 million to American Express' bottom line.

That would have added nearly $1 a share to Amex's earnings. What's to be done?

Cut the cost structure. Trim staff. Close branch offices. Get out of certain businesses. For example, other securities firms may be making lots of money from derivatives, but Shearson isn't.

Why doesn't American Express spin off Shearson now?

As a stand-alone company, Shearson couldn't get the ratings a company needs to borrow a lot of money on a day-to-day basis. Without American Express, you'd have chaos over there.

If Robinson is successful, then two or three years from now American Express will probably try to take Shearson public or sell it.

Let's talk about American Express' other businesses.

Travel Related Services has not returned to its previous levels of profitability in the Eighties and never will because of the competitive situation today. However, if you adjust its 1992 results for one-time events, and fully

John Abbott

Harvey Golub and James Robinson III of American Express

The boss got a reprieve; his protégé, a promotion. Now they must deliver.

tax those results at 34%, then last year the business earned just under 14% on average equity. Not terrific. This is an operation that probably can earn 16% to 17%. But significant progress has been made. Harvey Golub has done a good job there.

How about IDS Financial Services?

Last year IDS made $408 million, pretax, versus $314 million the year before, a 30% increase. It's in the right business, and is doing exactly what it should be—Golub did a decent job there as well.

The investment in First Data Corp., which does back-office and medical processing and billing?

First Data Corp. had a terrific 1992, will have a terrific 1993, and will grow at 20% for the next several years. At the current valuation of First Data, American Express probably has a $1.5 billion unrealized profit in its holding. At some point it will sell its 54% stake for a couple billion dollars.

Amex stock is still in the dumps. What could it be worth?

At some point in the next two to three years I think these shares will trade at 40 to 50. But there's a lot of work to be done at Shearson. Have all the writeoffs been taken? I haven't got the foggiest notion. I do know the cost structure is too high.

Are you buying the stock now?

I would like the dust to settle first. I would like to get a better feel about Robinson's program at Shearson.

So what are you telling your clients?

To trade the stock. All this media silliness about Mr. Robinson's personality could take the stock down to 21 or 22. In that case, why not buy it?

What is important is, can Shearson be turned around? I think it can be, but only by a very strong chief executive. They've picked Robinson. Can he do it? I don't know. If he can't, American Express has a major problem. But it has nothing to do with personalities.

For too long it was business as usual at United Technologies' huge jet engine division. Hard times and tough competitors are forcing a tradition-bound company to change its ways.

Welcome to the real world

By James R. Norman

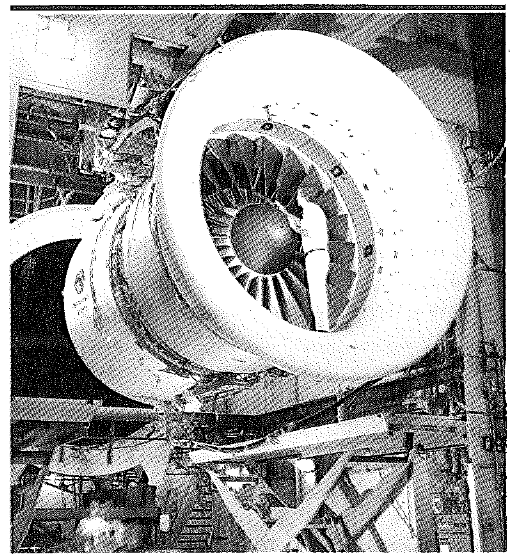
A CRISIS ATMOSPHERE prevails these days at the Hartford, Conn. headquarters of United Technologies Corp. as layoff follows layoff at the huge Pratt & Whitney jet engine division. Now another $700 million writeoff for 1992—mostly for Pratt & Whitney—has obliterated UTC's profits for the second straight year.

For Chairman Robert Daniell, this is a stunning reversal from the heady, profitable years of market dominance by Pratt & Whitney, when its JT8D engines powered virtually every 727, DC-9 and early 737. As recently as 1990, Pratt & Whitney had contributed two-thirds of UTC's operating profit on just one-third of sales. After the writeoff, it is now in the red.

UTC's Carrier air conditioners, Otis elevators, UT auto parts and Sikorsky helicopters are doing just fine, but with less cash flowing in from the jet engine business, UTC is an eight-cylinder engine running on four cylinders.

Chairman Daniell is a cautious engineer, but he has tackled the problems at Pratt & Whitney with grim determination. Recognizing—perhaps belatedly—the importance of controlling costs, Daniell last year handed the UTC president's job to George David, a brusque cost-cutter credited with reviving Otis and Carrier. UTC then took a $1.2 billion writeoff—22% of its net worth—with half of that at Pratt. But it wasn't enough.

So Daniell shuffled Pratt managers last fall, and he and David brought in from Carrier turnaround veteran Karl Krapek to head the unit. Karl Krapek sits on a very hot seat. Slimming Pratt & Whitney in line with dwindling orders for commercial jet engines has proved a tough task.


Fred Gaylor

Testing a new Pratt & Whitney engine
Coping with dwindling aircraft orders.

The stodgy but technically superb and fiercely proud engineering corps based in East Hartford has a knack for fending off corporate interference. "We'd send in young M.B.A.s and they'd get ground up by the stultifying bureaucracy," David frankly admits. "I don't think Pratt has run itself well for decades. It hasn't paid atten-

tion to costs, productivity or responsiveness."

How big is the problem? For instance: Pratt & Whitney has 10 million square feet of manufacturing space—mostly in high-cost Connecticut. That's 25% more space than rival General Electric has for roughly the same volume of engines. At its peak in 1990 Pratt employed 50,000 workers, versus fewer than 40,000 at General Electric Aircraft Engines, which got the jump on Pratt with its hugely successful CFM56 engine for the later version of the Boeing 737.

Right now Pratt & Whitney's work force is down to 40,000, with another 8,200 cuts just announced. Krapek's goal is to be down to 30,000 workers—GE's current level—by the end of next year.

"Pratt had never been forced to be trim and fit by the marketplace," says David. "Now it is exposed for the first time to the ravages of cost-based rivals who had to scramble in order to survive."

John Madere

UTC Chairman Robert Daniell (left) and President George David
After fixing Otis and Carrier, time to tackle P&W's problems.

The scrambling isn't over. From a heady production rate of more than 800 planes in 1991, commercial airframe makers Boeing, Airbus and McDonnell Douglas saw their new-order rate last year shrivel to about 300 planes, net of cancelations. Every plane not produced means at least two fewer engines. Analyst Tassos Philippakos at Moody's predicts that average deliveries will fall to 500 planes a year until the end of the decade—down nearly 40% from the 1991 level.

Military business is even worse. Pratt won the engine contract on the new F-22 fighter. Even so, Pratt will probably build only about 100 military engines a year, versus the 230 or so F100s it turned out in 1990 for the F-16 and F-15 fighters. "Order rates," Daniell glumly concedes, "are not coming back any time soon."

Meanwhile, third-place Rolls-Royce is determined to buy its way back to 30% of the engine market, from about 20%, targeting both GE and Pratt, which have about 40% each. The competition will be brutal. Since most planes are now designed to accommodate engines from various makers, price is crucial.

New rivalry is emerging also in the parts business from remanufacturers and the airlines' own repair shops. Like giving away razors to sell blades, engine makers earn little or nothing on engine sales, but make it up on the spare parts—or used to. From $175 million a month, sales of commercial spares have plunged by about half in recent months. This really hurts; spares are a business in which operating profits can run to 65% of revenues.

But if Daniell, David and Krapek can bring costs in line with the lower revenues, all is not bleak at UTC. Cash flow should improve as R&D spending on upgrades of Pratt's big PW4000 engine winds down. And if there are no further big writeoffs, UTC could earn $5 a share in 1993, what with its other divisions doing well. At Pratt & Whitney R&D and capital outlays for powerful new engines, recently running at $500 million a year, are on the decline.

But the UTC executive team doesn't have forever. Kidder, Peabody analyst Michael Lauer figures that at current market prices—less than $50 a share—UTC sells for about what Carrier and Otis alone are worth, with Sikorsky and P&W thrown in for free. Investors these days are mighty impatient with management with underperforming assets. Ask Robert Stempel. Ask John Akers. Ask Robert Daniell.

Newspapering has almost always been a mostly local business. Though he runs a national company, Tribune Co.'s Charles Brumback runs it in an intensely local way.

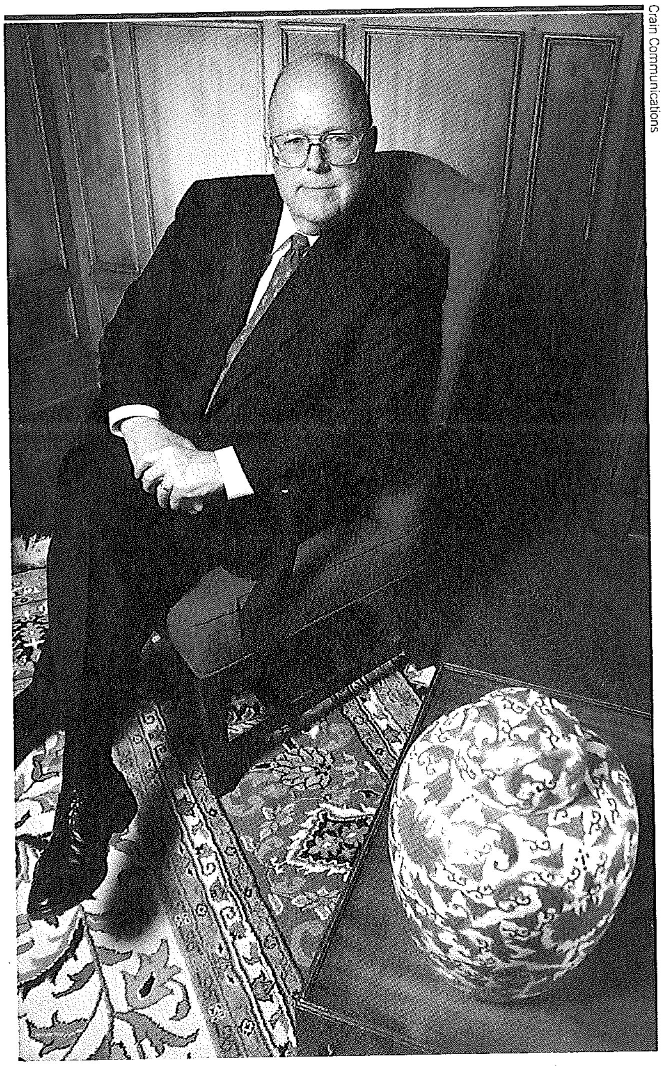
Hometown coverage

By Christopher Palmeri

IN A NEW BOOK, *Read All About It!*, former *Chicago Tribune* editor James Squires lashes out against corporate publishers who put profits before Pulitzers. Considering some of the tripe that has won Pulitzers, this isn't quite the put-down Squires intends it to be.

Squires also paints a harsh picture of current Tribune Co. Chairman Charles Brumback, who comes across as a tightfisted accountant heartlessly crushing Chicago's newspaper unions. Considering what the unions have done to newspapers, that's more a compliment than an insult.

In the old days the *Chicago Tribune* proclaimed itself the World's Greatest Newspaper on its own front page. Nobody except a few local boosters and the eccentric publisher Robert McCormick bought that claim. Anyhow, Brumback isn't interested in such boasts. "The future of newspapering may not be putting ink on paper," says Brumback. "If we don't figure out what that future is, somebody else will."



Crain Communications

Tribune Chairman Charles Brumback **"The future of newspapering might not be putting ink on paper. If we don't find out what that future is, somebody else will."**

Gone are the glory days when the local newspaper was the main medium of mass communication and when many people read two, even three, papers. As Brumback is well aware, that ended with TV and with changing lifestyles. Young people are not reading newspapers, advertisers have many other ways of reaching local consumers, and the old-fashioned newspaper's one-size-fits-all approach to coverage no longer fits a more fragmented society.

From his office high up in Chicago's gothic Tribune Tower, Brumback sees all this and has been fashioning a strategy to keep his company prospering in what may develop into a post-newspaper age in which the old broadsheets survive but play a dwindling role.

Now 64, this graduate of Culver Military Academy, who earned a Bronze Star in Korea, became chief executive of the $2.1 billion (revenues) Chicago Tribune Co. two years ago. Most newspaper companies have solved the problem of slow local growth by buying family-owned newspapers and thus expanding geographically. Brumback's strategy calls for expansion in depth rather than in breadth.

The Tribune Co. has strong posi-

tions in good markets, all of which continue to offer expansion potential. Tribune Co. owns seven dailies in hot cities like Orlando and Fort Lauderdale. It dominates Chicago. It owns seven independent television stations in major markets such as New York, Chicago and Los Angeles. And it owns baseball's Chicago Cubs.

Brumback told his executives to spend money creating targeted publications and programming to penetrate the areas where they were already strong. Tribune's Fort Lauderdale paper created two colorful weekly tabloids targeting non-newspaper readers, namely young people and Hispanics. One of them, *XS*, a free weekly entertainment guide, was profitable in its first year. *¡Exito!* ("success" in Spanish) prints its business section in English because that's the language in which Hispanics feel most comfortable reading about business news.

The *Chicago Tribune* has launched two much-talked-about weekly sections: Kid News and WomaNews, whose features aimed at working women are now syndicated in 50 other newspapers. The *Tribune* has also been a leader in following its readers out to the suburbs. Five separate daily sections cover local communities, and the paper has more reporters covering local news in the suburbs than they do downtown.

Emphasizing local markets has certainly worked in broadcasting. Tribune's stock took a dive along with other operators of independent stations when Rupert Murdoch announced the creation of the Fox Network seven years ago. Independents, the thinking went, would never be able to compete with another television network.

The Fox Network did well, but so did many of the independents. Last year Tribune's stations brought $550 million in revenues. That's more than the seven Fox-owned stations or CBS' seven owned-and-operated stations brought in last year. The Tribune stations use a strategy similar to the newspapers': Go local and stay local. They emphasize local news, sports and, to a large extent, Tribune-created programming. Tribune's Los Angeles station sticks to local news, traffic and Hollywood gossip on its new morning show and gets higher ratings than the networks. That's right, better ratings than *The Today Show* and *Good Morning America*.

In Chicago, Tribune's independent WGN brings in more revenue than any of the three network-affiliated stations. More than 40% of WGN's programming is produced internally. This includes talk shows like *Geraldo* and *The Joan Rivers Show*, creations of Tribune Entertainment, the company's syndication arm. WGN also broadcasts more home-team sports, including the Cubs, the White Sox and the Bulls, than any other television station in America.

Ilene Ehrlich

A newspaper war rages in Chicago

Charles Brumback lost a skirmish, but he is better positioned for the battle ahead.

Brumback clearly would like more of such local TV. Last year he picked up 75% of a non-network Philadelphia television station, WPHL, valuing it at just $40 million, or less than eight times cash flow. More broadcast acquisitions are likely to follow. Expect all of them to be heavily local in their programming.

Last month the company launched ChicagoLand Television, a $10 million experiment to deliver 24-hour local news on a cable TV channel. Brumback has also teamed up with America Online, a Prodigy-like interactive computer service, to deliver the *Chicago Tribune* via computer. Tribune Co.'s $5 million investment in the publicly held firm is now worth $14 million. The computer service may never replace the printing press, but again it might. "It's research and development," says Brumback of his electronic ventures. "I'm prepared to lose it all."

In areas where Brumback can't be strong, he'd rather not fight. In early 1991 he sold the loss-plagued New York *Daily News*. This month the company is selling one-third of the stock in Quno Corp., a Canadian newsprint subsidiary, whose cyclicality has dragged down earnings.

In Chicago, Brumback recently seemed to have lost a skirmish. The *Trib*'s daily competitor, the *Sun-Times*, has been bragging about winning a recent newspaper war. After the *Tribune* raised its newsstand price from 35 cents to 50 in September, the scrappy *Sun-Times* held its price at 35 cents. The *Sun-Times* now says it has grabbed the largest circulation gain any Chicago paper has managed in 15 years. However, the *Trib* is still well ahead in circulation.

The *Sun-Times*' gains won't last, insists Brumback. In time, the *Sun-Times* will have little choice but to raise its price, too, to cover an increase in the price of newsprint, of maybe 12%, that looms over the newspaper business. Then, says Brumback, the *Trib* will get back what it has lost.

Brumback's strategy has won favor on Wall Street. Goldman, Sachs analyst Eric Philo says he expects Tribune's earnings to rebound this year nearly 40%, to $2.70 per share. The numbers certainly look good. The Tribune Co. averaged 17.5% in return on equity over the last five years, including 1992 estimates, according to Value Line. The industry average is 11.6%. In terms of operating margin, Tribune averaged 20.4%, versus 18.4% for the industry over the same time period, same source.

Pondering ex-editor James Squires' critique of him, Brumback says: "We'd all love to return to the days of swashbuckling publishers exposing political shenanigans. But Jim's vision is through a rearview mirror." Looking through the windshield, Charlie Brumback sees media that are still intensely local but no longer in the old ways.

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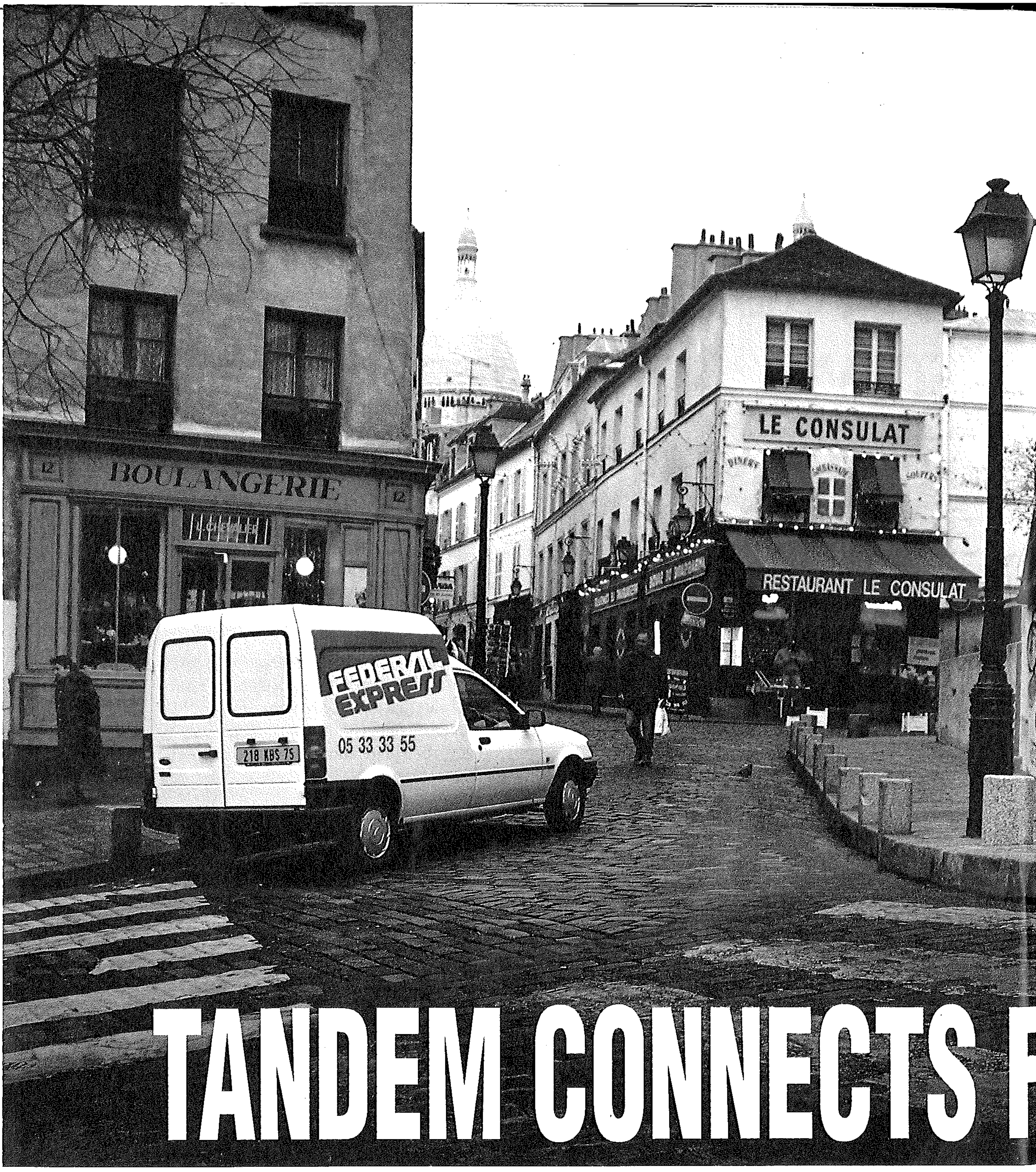

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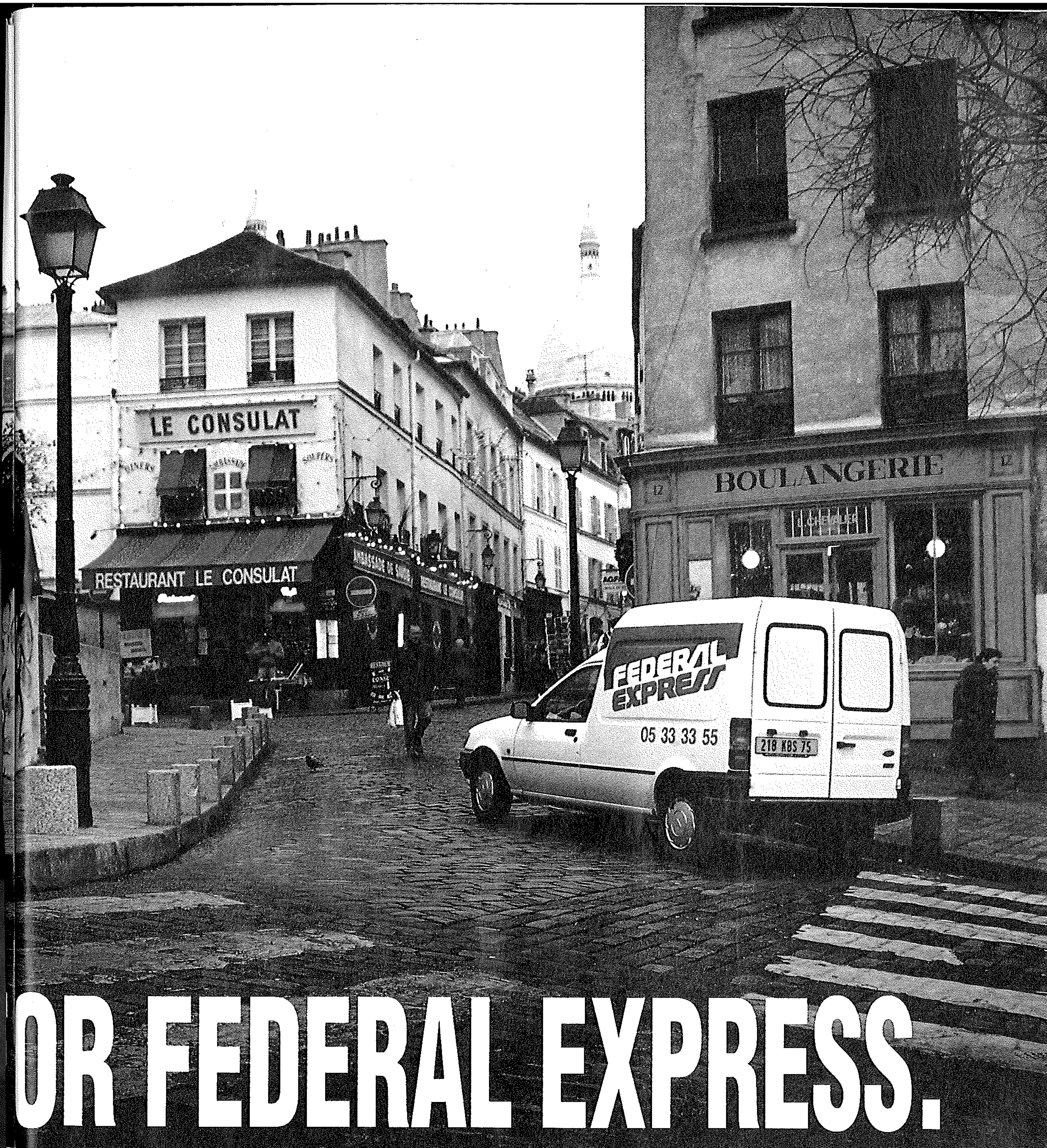

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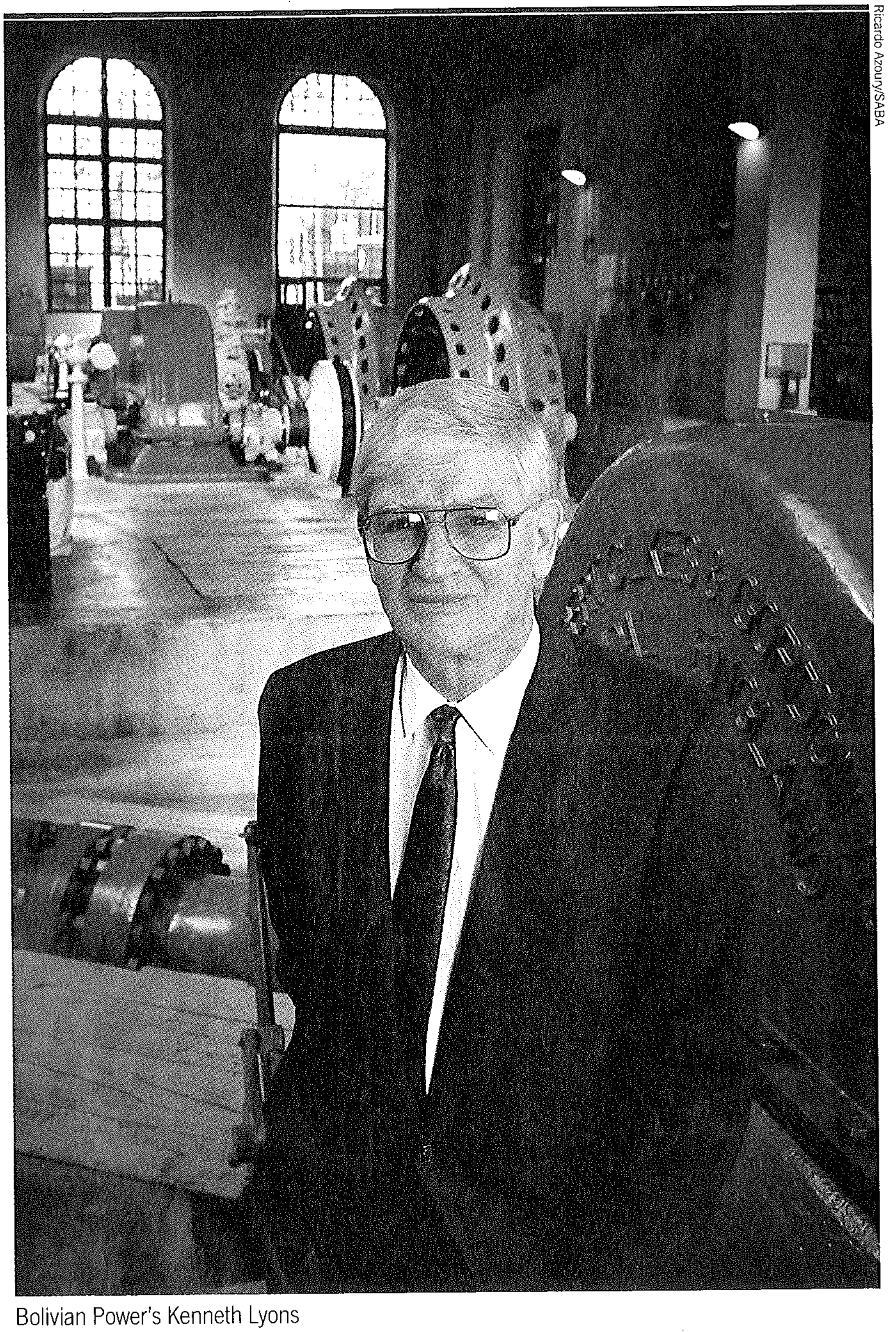
A leftover from the great days of colonial investment in South America, Bolivian Power survived coups and hyperinflation, thanks to the efficient efforts of a modest English engineer.

Stiff upper lip

By Joel Millman


Ricardo Azoury/SABA

Bolivian Power's Kenneth Lyons
A three-year contract stretched to nearly four decades.

KENNETH LYONS may be the last of a once-vibrant breed: the British jungle entrepreneur. Three months after finishing his engineering studies at Widnes Technical College in Lancashire in 1956, Lyons, then 22, took off for Bolivia, where he was hired as a contract engineer with Boliviana de Energia Electrica S.A. It took him four days to get there—via Africa to Brazil, Brazil to Buenos Aires, Buenos Aires to 15,000 feet up in the Andes.

"I went on a three-year contract," Lyons says with a smile. Two years in, he married a Bolivian woman and decided to stay a while. He's still there and is now ending a glorious career.

Bolivian Power, as it's known in English, served just 35,000 of the nearly 150,000 homes in La Paz when Lyons started and made much of its money supplying power to the big mining companies nearby.

Three decades later, Ken Lyons is still lighting La Paz. His Bolivian Power (1992 revenues, $36 million) is probably the only foreign-owned utility in Latin America to escape nationalization. "There must have been a dozen attempts at expropriation," says Lyons, with an understated chuckle. "But with so many changes in government, no one was ever in power long enough."

In the past 40 years Bolivia has had at least 20 coups; only a handful of its presidents served out their terms.

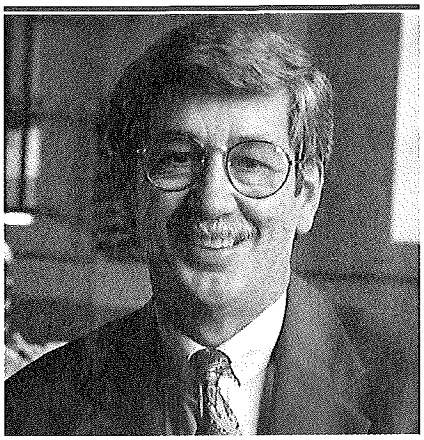
Eduardo Gamarra, a political scientist at Florida International University who grew up in La Paz, says Bolivian Power stayed private largely because management did such a good job that the pols were afraid to touch it. "Some politicians in La Paz always opposed nationalization," he says. "They thought it would mean the cost of electricity would increase."

Lyons, who took over day-to-day operations at Bolivian Power in 1982, was careful to stay one step ahead of growing demand, investing in new plants every couple of years and constantly upgrading his existing ones. Bolivian Power's 85-year-old Achachicala hydroelectric plant in La Paz is still operating at 100% capacity. Fifteen thousand feet above sea level, its Zongo Valley system is made up of eight generating plants, some dating back to the 1930s.

Lyons' meticulous care for the

plants he inherited makes sense. While hydropowered plants are more expensive to install than fossil fuel plants, they are much cheaper to run. By squeezing eight decades of service out of some plants, Bolivian Power has been able to keep rates among the cheapest on the continent—less than 5 cents per kilowatt-hour. "No other power generator in Latin America sells electricity for less," boasts Lyons, "and still makes money."

But Lyons has had to contend with more than constant changes in government. His bosses have changed almost as often and just as erratically.



Ricardo Azoury/SABA

Heir apparent Roger Dupuis
Lighting La Paz.

Bolivian Power's first parent, Canadian International Power, was swallowed by conglomerator Morley Thompson's Baldwin-United Corp. When Baldwin-United filed for bankruptcy in 1983, control of the utility passed into the hands of U.S. insurance giant Leucadia National. Leucadia got it when it bought controlling interest in Baldwin-United. Leucadia continues to hold about 50% of Bolivian Power's 3 million shares. The rest is traded on Nasdaq.

Lyons has never cared who owned the company. "Remember that communication between Bolivia and the outside has only become part of life in the past five or six years," he says, savoring the fact that a succession of owners have left him alone.

And a good thing, because this isn't the kind of business you can run from London or New York. There was Bolivian hyperinflation to contend with, sometimes roaring along at 25,000% a year. "Our consumers had 20 or 40 days to pay," says Roland Gibson, Bolivian Power's financial vice president. "So with inflation at that rate, the payments were almost worthless when we got them."

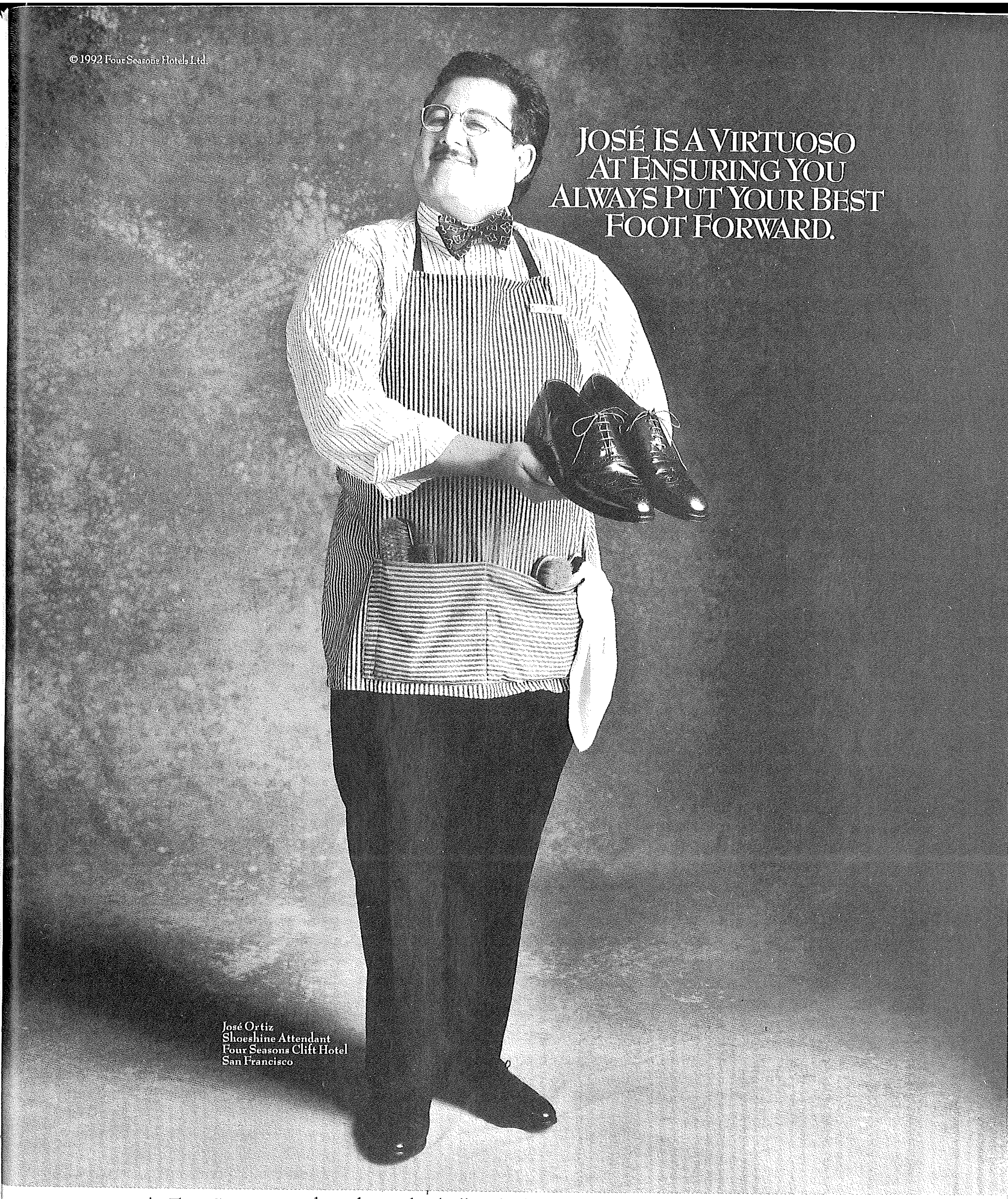
Close to closing its doors in 1984, Bolivian Power survived only because its biggest customer—the state mining monopoly, Comibol—paid its bill in dollars, not pesos. "The mines got us through," Lyons says. "That was our life belt."

Right now it is prosperity, not hyperinflation, that Bolivian Power must cope with. Higher metals prices and falling inflation have combined to make La Paz one of Latin America's fastest-growing cities. Bolivian Power now serves over 150,000 homes, and with demand for electricity growing by about 6% a year, the company faces the daunting task of keeping up with it. Over the next five years the company will spend $120 million to expand four plants and build two new ones in the Zongo Valley. To raise the money, the currently debt-free company will have to sell bonds—and possibly make an equity offering. With the government's recently having renewed Bolivian Power's contract for another 40 years, it should have no trouble raising the money.

The company's revenues have increased 138% in the past five years, and earnings per share have nearly doubled, from $1.07 to an expected $2 this year.

All this has made the little company quite attractive to foreigners wanting a stake in Latin America. Bolivian Power's shares, at a recent 14, have doubled over the last two years. That price, however, is only about half book value and less than five times the $3 a share analyst Barry Sahgal of Ladenburg, Thalmann & Co. thinks the company could earn this year. The stock yields a respectable 4.6%.

Having steered Bolivian Power through turbulent times, Ken Lyons, 59, is handing over the reins to his right-hand man, Roger Dupuis. He says he's going back to Cheltenham in southwest England to plant roses, do some reading and reacquaint himself with British life. His own modest verdict on his enviable career: "It's such a small company, you know, but we met our objectives."



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A lot of businesses are picky about their suppliers. National Re is extremely picky about its clients. That's one reason its earnings are headed upward.

Know your customer

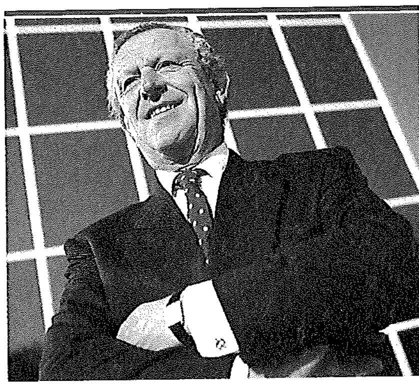
By Carolyn T. Geer

WHEN TIMES are tough, you try to broaden your customer base, right? Not National Reinsurance Corp. When hurricanes rage and price wars loom, National Re remains fussy about which companies it will accept as customers. Out of more than 3,000 property/casualty insurers in the U.S., only 300 make National Re's list of desirable clients. It is now doing business with a quarter of those.

Stamford, Conn.-based National Re makes its living by absorbing some of the risks undertaken by small property/casualty insurers. This explains its pickiness. "You can't eat off a dead horse," says William Warren, the company's chief executive. "We learned a long time ago that there's no way we can make money over the long haul reinsuring a company that doesn't run its business well." Since it is sharing risks, National Re wants to do business only with companies that take sensible risks for a sensible price.

Here's how the business works. Say the owner of a grocery store buys a $5 million liability policy to insure against the cost of a lawsuit should a customer slip on an orange peel. The grocer's insurer in turn becomes a customer of National Re. For a price, National Re agrees to shoulder any losses exceeding the first $500,000 on that policy. Obviously, Warren wants to reinsure grocery stores that keep the aisles clean.

Top-performing Cincinnati Financial Corp. (FORBES, *Jan. 4*) has been a National Re client for years. National Re also will share risks with new companies if it likes their looks. Says Warren: "We like to do business with people who want to build businesses." And who own a piece of them. "They do a better job when their own money is at risk," he says.



Kenneth Chen

National Re's William Warren
"You can't eat off a dead horse."

You could say the same about Warren and his company. Warren, 56, has been running National Re since 1980, when it was a subsidiary of Continental Corp. But he has been a significant shareholder only since 1990, when a group affiliated with billionaire Robert Bass bought the firm. Warren got 213,000 shares of insider stock at $4.32 each.

Following a public offering a year ago at 23, National Re shares have climbed to a recent 32. Analysts are expecting earnings to climb from $18 million in 1992 (excluding capital gains and a one-time charge) to $38 million, or $2.25 a share, in 1993.

When Warren and his aides like a company, they love it. They underwrite, on average, 75% of a client's reinsurance business. This is good for the clients, who are often smallish companies with limited capital. It puts Warren in a partner-like relationship with his customers, with his fortunes intertwined with theirs.

Los Angeles area-based Crusader Insurance Co., a client since 1985, suffered $21 million in losses from last year's looting, saddling Warren with a $5 million loss. Legally, this was Warren's only obligation to Crusader. Nonetheless, National Re lent Crusader an additional $2 million to help rebuild its surplus. Further, it bought $800,000 worth of shares of Crusader's parent, Unico American Corp., at market prices. (Unico's chairman kicked in $36,000, too.)

There was nothing out of the ordinary in going the extra mile for a customer. "If their losses were coming from bad business practices, we wouldn't have done it," explains Warren, "but [the looting] was a discrete event. They're a good account, and they needed help."

Warren learned about pricing insurance and picking partners the hard way. When he was promoted to head of National Re, he discovered that the firm, notwithstanding a top rating from A.M. Best, was underreserved by at least $75 million. Why? The company had been underpricing its product. "We were damn near terminally ill," says Warren.

Warren prescribed bitter medicine. He threw out unprofitable business, dropping premium volume from $185 million in 1979 to $75 million in 1982. "We feel you cannot stay in the game and compete on price," explains Warren. From there he began to rebuild, but slowly. Last year's premium revenue was $250 million.

Following a year in which primary insurers took a beating from Hurricane Andrew, demand for reinsurance is strong, yet many reinsurers are in no financial position to write more business. National Re is different. Bolstered by the 1992 equity offering, National Re's capital surplus will support a lot of new business. But William Warren is taking his time and picking his shots carefully. He is taking on annual premiums equal to only 80% of National Re's capital surplus, much less than the 150% it could comfortably take in. It's a reinsurer's market, and Warren intends to make the best of it.

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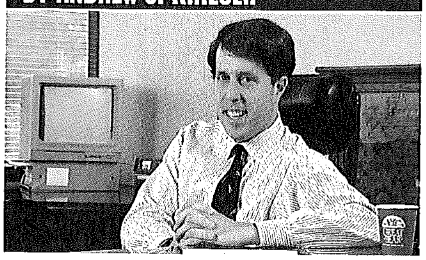
February 15, 1993 Reader Service Card—Offer expires May 15, 1993

The yen is going to make a big move against the dollar in the next few months, but I'm not yet ready to say which way it will move or how far.

Too soon to call

BY ANDREW J. KRIEGER



Andrew J. Krieger is managing director of KB Currency Advisors, Inc., a foreign exchange investment management and hedging/advisory firm based in Englewood Cliffs, N.J. He is author of *The Money Bazaar.*

I AM STILL cautiously bullish on the dollar versus the deutsche mark this year (*see my column, Feb. 1*). Germany's cyclical weakness contrasts sharply with the modest growth that the U.S.' economy is currently experiencing. Divergences in their respective economies will likely lead to a continued narrowing of interest rate differentials, which in turn is widely anticipated to fuel a significant dollar rally. This is the consensus view, and though I rarely follow consensus views it looks correct in this instance.

The situation vis-à-vis the dollar-yen exchange rate is much less clear, however. Japanese industrial production has been declining and inventories are rising relative to sales. Job opportunities there are narrowing, and there has been a reduction in overtime. Households have displayed a reluctance to spend, and new housing starts are likewise slowing.

Japanese net exports have provided the main contribution to economic growth, as the current account surplus has grown to over $11 billion per month. This surplus, however, is generating increasing cries of protest among Japan's trade partners, and threats of protectionism are becoming a real danger.

In a sense, one can view the Japanese economy as being built on a continuing need for growth and expansion lest the structure collapse in on itself in a massive heap of deflated assets. During the 1980s and early 1990s Japan embarked on an astonishingly ambitious capital spending investment program in which Japanese investors pumped over $1 trillion into plant and equipment and manufacturing enhancement. Without continued export growth a lot of this investment will never pay off.

The danger of the Japanese situation is worsened by the political scandals that have hurt prospects for badly needed economic stimulus.

As against these negatives, upcoming elections will increase the domestic pressure for a growth package and international pressure will mount for Japan to take some action to boost its domestic economy and thereby help reduce its dangerous and unsustainable external trade imbalances.

I think that the Japanese authorities will finally and belatedly recognize the severity of the current situation. The Bank of Japan will lower the official discount by 50 basis points, to 2.75%, and there will be an additional boost to infrastructural expenditures. There will also very likely be a cut in personal taxation.

However, the action will be reflexive not pro-active, so the problems will not be sufficiently addressed to ward off a recurrence in the future.

Does this somewhat pessimistic view of Japan's immediate economic prospects make me negative toward the yen? Not necessarily. The Bank of Japan has lowered interest rates quite dramatically over the past several years, and Japan may very well be close to a cyclical low in both its rate structure and its economy. Furthermore, even if the next dosage of fiscal and monetary stimulus proves to be insufficient, the enormous trade surplus creates a steady demand for yen, as foreign sales are translated back into the domestic currency.

One must also consider that part of the perversity in foreign exchange is that over relatively short periods of time (e.g., three to six months) there is no clear correlation between relative economic performance and the relative strength of the currency. Capital flows anticipating shifts in monetary or fiscal policy, or coordinated governmental intervention, are more likely to drive a currency higher or lower than actual levels of domestic output.

The bottom line is that I can't now formulate a convincing argument for either a surging or collapsing yen. This, however, is not to say that I expect the dollar/yen rate to remain stable. In the next few months a major move will begin. The monstrous trade, capital and speculative flows in and out of Japan will finally build up an overwhelming tidal wave of pressure, which will yield a giant currency shift. But I'm not yet ready to make a bet on the direction.

In the Nov. 23, 1992 issue of FORBES, I recommended that my readers sell at 63 ticks 50% of their March 66 Aussie puts, which had originally cost 23 ticks. It is time to take profits on the balance of the position at 82 ticks.

Health insurance covered your surgery. Life insurance protects your family. Car insurance guards the old jalopy. Your homeowner's policy even protects the chair you're sitting in.

All you can lose is the nest egg that lets you sit there.

Invacare's Mal Mixon plotted his chief competitor's downfall with the precision of a military campaign.

Wheel-to-wheel combat

By Christopher Palmeri

THE FIERCEST COMPETITION in the $1.3-billion-a-year market for home health care equipment—beds, commodes, walkers and the like—is for wheelchairs. So far, Elyria, Ohio-based Invacare Corp. is winning most of the battles.

Invacare? Fourteen years ago it was a tiny division of giant Johnson & Johnson, and going nowhere fast. Then a J&J manager named Malachi (Mal) Mixon and a group of investors did a leveraged buyout, paying $8 million for Invacare, which was then doing less than $20 million in sales.

Last year Invacare earned an estimated $17 million ($1.25 a share) on sales of $308 million, according to Baird & Co. analyst Peter Emch. Mixon, now Invacare's chairman, and his partners took the company public in 1984. With the stock recently at $24 a share, Mixon's 8% stake is worth nearly $25 million.

Mixon, 52, detected weakness in Invacare's chief competitor. Everest & Jennings International had over 80% of the wheelchair market, but, says Mixon: "They were arrogant and had lost touch with the customer."

Before earning a degree from Harvard's business school, Mixon served in Vietnam as an artillery officer in the U.S. Marine Corps. He plotted E&J's downfall as if planning an artillery strike on a massed North Vietnamese division. First, he stockpiled ammunition, strengthening Invacare's distribution network, so that the nation's 6,000 independent home health care dealers could easily get his product. Mixon offered the dealers prepaid freight, 48-hour delivery, cheap financing, money for cooperative advertising, and volume discounts.

In 1982 Invacare introduced a new product: a motorized wheelchair with the industry's first computerized controls. Invacare's controls could be easily adapted to the specific needs of the severely disabled. At more than $3,500 per chair (paid almost entirely by health insurance plans), it is still the industry standard.

Everest & Jennings fought back by cutting prices. But lean production techniques helped Invacare match the cuts. Many of Invacare's standard chairs are now produced in a low-cost *maquiladora* plant in Mexico. Today E&J has about 20% of wheelchair sales

Bruce Zake

Invacare's Mal Mixon
Commanding the wheelchair wars.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Quikie Designs'
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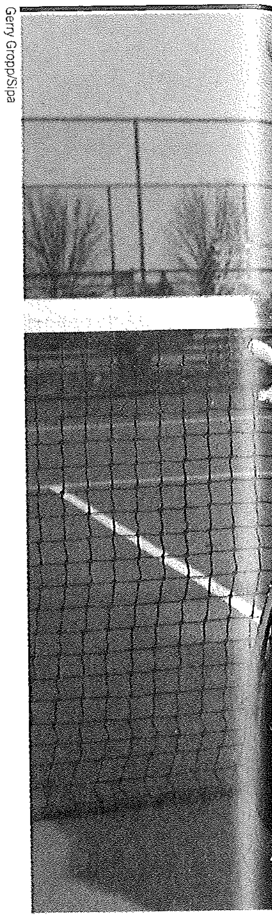
Making chairs you can play tennis in.



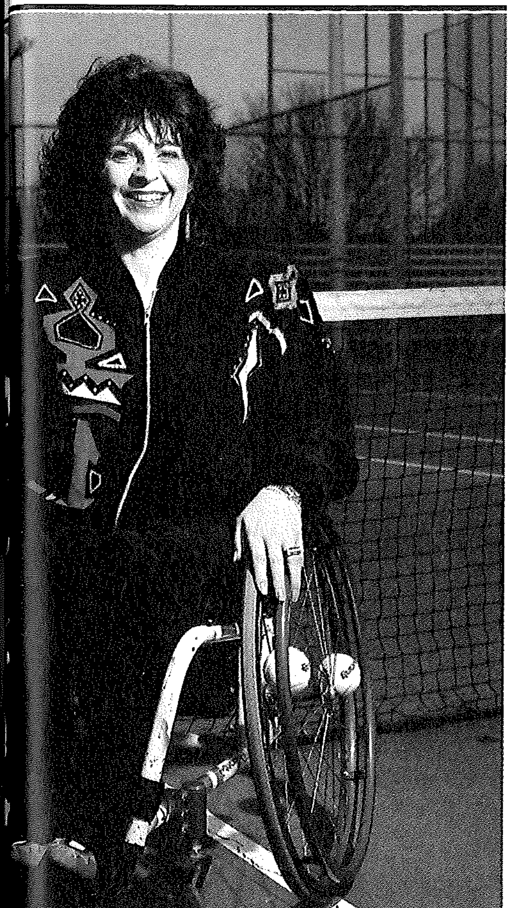
Gerry Gropp/Sipa

and the company is in the red.

These days Mixon's toughest opponent is Quikie Designs, a maker of ultralightweight wheelchairs that is owned by Sunrise Medical Inc. of Torrance, Calif. Quikie was cofounded by Marilyn Hamilton, a bubbly Californian who was paralyzed in a hang-gliding accident. Using aircraft-quality aluminum frames, Hamilton cut her chair's weight from 60 pounds to 25 pounds for a hand-powered chair, and made it available in jazzy colors. Sunrise, the parent company, promotes Quikie chairs to active users by sponsoring Team Quikie, wheelchair athletes who compete in tennis, basketball, racing and skiing events for the disabled.

Quikie's chairs sell for $1,700 and up, versus $800 for a standard lightweight chair. But Quikie has captured 60% of the rapidly growing, $80-million-a-year market for ultralightweight chairs. And Quikie now has its own line of motorized chairs.

Mixon isn't about to let Quikie do to him what he did to Everest & Jennings. He developed his own



ultralightweight Action chair, and began marketing it with a sense of humor. "Why settle for a Quikie?" jokes one of Invacare's promotional buttons, "Get real Action!"

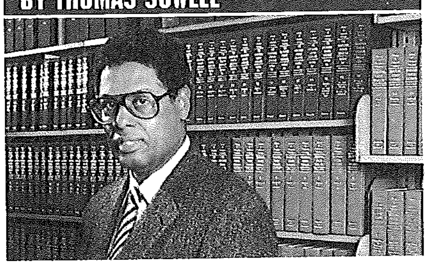
Mixon's strategic advantage: Invacare's heavy dealer orientation. Unlike most medical products, wheelchair purchases are influenced less by a doctor's recommendation than by test drives with a dealer and a physical therapist. Mixon has added crutches, oxygen concentrators and other home health care products to Invacare's line. Because dealers get volume discounts on everything Invacare makes, the new products are a powerful incentive for dealers to push Invacare's high-margin wheelchairs.

Recently the battle has swung to Europe, where the $250-million-a-year wheelchair market is consolidating rapidly. Invacare's acquisition this past November of a leading French company pushed it into the number two position in Europe behind Meyra GmbH, a privately held German firm. Promises Mixon: "I don't like being number two in anything." ■

Clinton's Cabinet may or may not look like America but it certainly doesn't think like America.

The anointed

BY THOMAS SOWELL



Dr. Thomas Sowell is an economist and a senior fellow at the Hoover Institution in Stanford, Calif.

MUCH HAS BEEN MADE of the fact that the Clinton Administration's Cabinet "looks like America." Apparently looks count—and a quota isn't a quota unless you call it a quota.

Where performance is the criterion, seldom does that lead to an even "representation" of the various groups in any society.

Basketball fans do not expect to see teams that "look like America." No one cares that the leading beer companies in this country have German names, or that Asian Americans are statistically "over-represented" in science and engineering.

Wherever there is open competition, this has produced demographically uneven distributions of people in all sorts of endeavors, in countries around the world and down through history.

Commerce and finance in the Ottoman Empire were dominated by people who were not Turks, as they were dominated in medieval Spain by people who were not Spaniards, and in 20th century Thailand by people who were not Thais. Most of the college degrees in Malaysia were earned by people who were not ethnically Malays—until quotas were instituted.

Demographic representativeness is seldom achieved in a multi-ethnic society without quotas, whether or not people are honest enough to call them quotas.

Those of us old-fashioned enough to be concerned about how people think and perform, rather than how they look, will find that the Clinton Administration Cabinet does not think like America, and is unlikely to act in accordance with the values or beliefs of most Americans.

As regards economic policy, the Clinton team is almost uniformly in favor of a larger role for government. Some of them talk about the deficit—as a prelude to asking for higher taxes—while others are just bursting with bright ideas for specific interventions in the economy. But the bottom line in both cases is more government.

Those who talk about the deficit are often called "conservatives," but invoking the deficit to justify higher taxes accomplishes nothing more than to channel a higher percentage of the nation's resources through the government. If raising tax revenues would reduce the deficit, we would have achieved a surplus years ago, for tax revenues doubled between 1980 and 1991.

The more straightforward advocates of activist government are perhaps epitomized by Robert Reich, selected by Clinton to be Secretary of Labor. Although the media keep referring to him as "Professor" Reich and an "economist," he is in fact neither. Although he has long been a fixture in the media, bubbling over with ideas for reshaping the economy, Reich has a law degree, and the Kennedy School has never conferred on him the title of "professor."

Among the latest in the never-ending stream of bright ideas by Robert Reich are increases in the minimum wage and mandating training costs on employers, both of which make it more expensive to hire low-skill labor, and can be expected to make it harder for young people to get a start in the labor force.

Then there is Laura Tyson, a Berkeley professor of economics, selected to be chairman of the Council of Economic Advisers in the new Administration. Professor Tyson has a long history of favoring more government intervention in the economy. Just a few years ago, she even had good things to say about the government-controlled economies of Eastern Europe.

Conversely, in 1990, she referred to the "free market frenzy in the United States during the past decade." We need fear no such frenzy during the Clinton Administration.

Professor Tyson is one of those clever people who can show that the real world does not conform to the abstract textbook models of economic competition, and therefore—here is where the leap beyond logic comes in—politicians' decisions should replace the flawed and shortsighted decisions of others.

By parallel reasoning, one could show that the law of gravity does not follow the abstract textbook model, whose scientific formula for the speed of a falling object leaves out air resistance. Nor do the chemicals of the real world coincide with the 100% pure chemicals assumed in textbook formulas for chemical reactions.

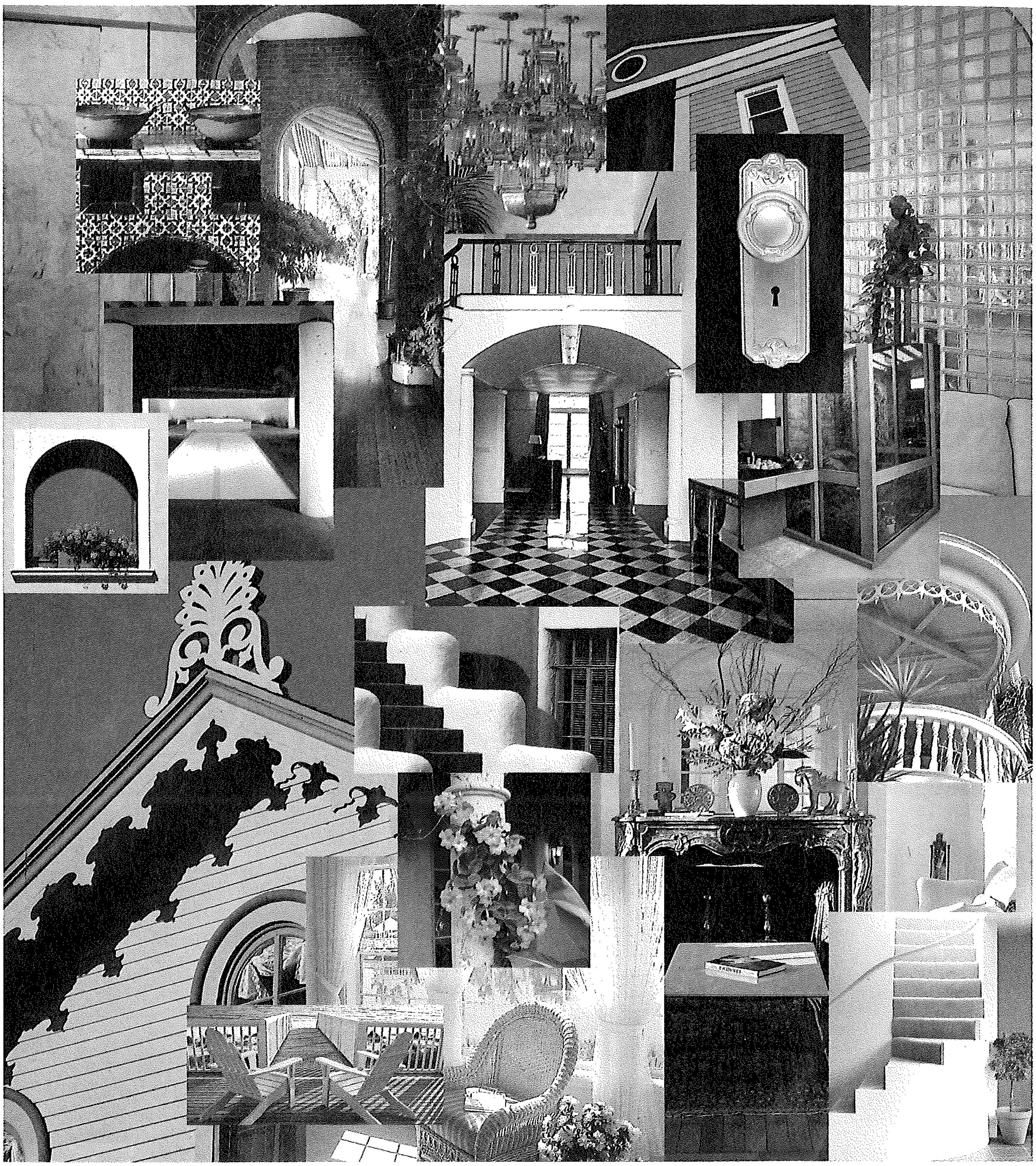
But would anyone wave aside the principles of physics and chemistry, and say that such things should be determined in Washington?

Even within the field of economics, one could just as easily have started with the proposition that the decisions of government are flawed and shortsighted, and concluded that therefore such decisions should be replaced by the decisions of the marketplace.

There is method in the madness of such people as Reich and Tyson. Their consistent theme is that people like themselves should be preempting the decisions of the rest of us, that the anointed should be able to experiment with the money, the jobs, and the futures of their fellow Americans.

That idea doesn't sound like America, no matter what the Cabinet looks like. ■

Details.



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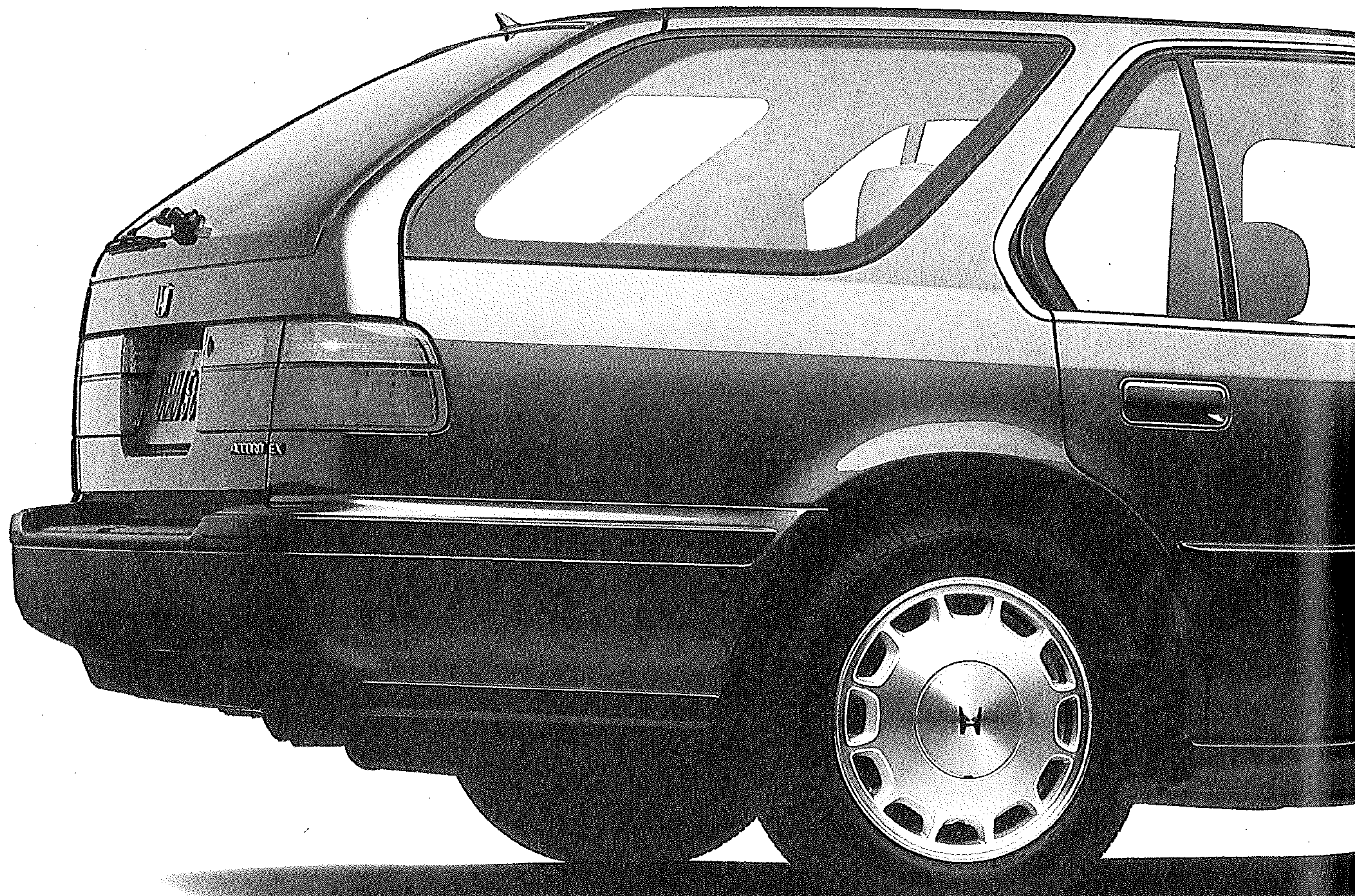


Would you like a very entertaining car that features a 140-horsepower engine, anti-lock brakes, a driver's si

The unions are geared up to ask Bill Clinton to prevent hundreds of thousands of people from working at home.

New outlaws?

By Jody Brennan

Jim Daniels

Carol Roberts knitting hats in her home in Maine

"I just want the government to leave me alone."

CAROL ROBERTS, of Gorham, Me., works hard to help support her family. Married and with three children, Roberts, 43, works at home knitting sweaters, hats and mittens for a distributor who then sells the knitted goods to retailers. The distributor provides Roberts with yarn and designs; Roberts produces on a piece-rate basis that in effect pays her upwards of $10 an hour.

Roberts' husband works full time as a parts inspector at a local GTE Sylvania plant, but the couple can't make it on one salary alone. With one child in college and fat monthly mortgage payments, Carol Roberts' knitting income is desperately needed. But if the country's big labor unions have their way, she may lose her job.

Roberts is what the unions call an "industrial homeworker," meaning she does in her home what could be done in a factory. The AFL-CIO estimates that there are more than 600,000 industrial homeworkers around the country. Most of these workers are women, and many work one way or another in the apparel industry.

Unions don't like people like Carol Roberts. Homeworkers don't join unions, and they compete against union labor. In 1938 Congress and the Department of Labor banned industrial homework in seven industries: ladies' garments, jewelry, gloves and mittens, buttons and buckles, handkerchiefs, embroideries and knitted outerwear. But in the 1980s exceptions were created to allow homework in all but ladies' garments and some jewelry.

With the Democrats back in the White House, the AFL-CIO is now hoping to eliminate these exceptions. Says John Zalusky, AFL-CIO head of wages and industrial relations, "When the opportunity exists, we're going to the Hill as well as to the Administration to make sure the [1938] ban is reinstated [for the exempt businesses]."

There's even been talk of expanding the homework ban to service industries, where rapidly improving technologies are making a daily commute to an office unnecessary. For example, some data entry employees for insurance companies are now set up to work from home.

Working at home has obvious benefits beyond the merely monetary ones. Working mothers can spend more time with their children. Older workers can supplement their Social Security checks.

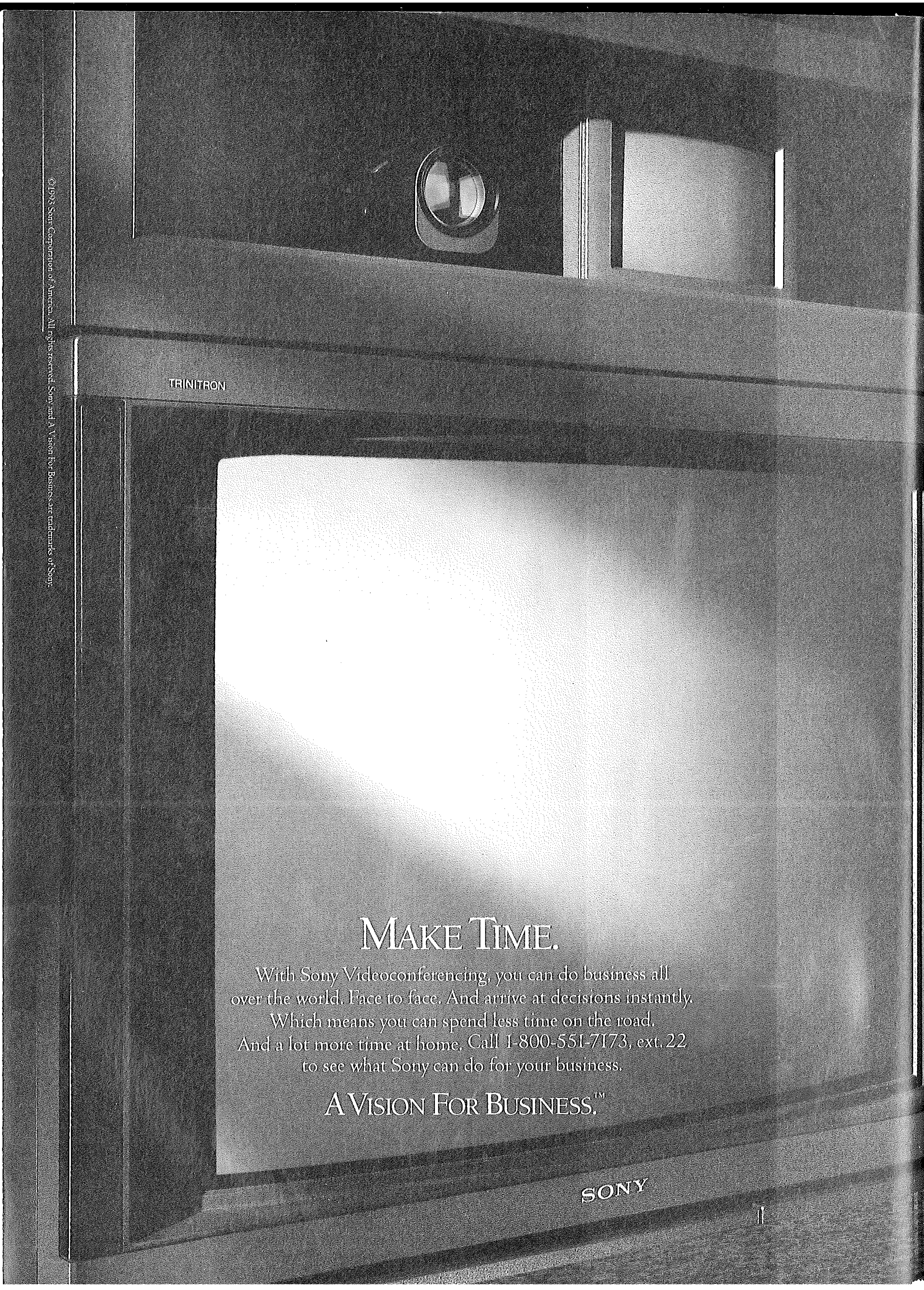
In some rural areas, the extra income from homework can mean the difference between holding on to a family farm and losing it.

The unions are unmoved by such arguments. Officials of the International Ladies' Garment Workers' Union insist that homeworking merely encourages exploitation—that economically desperate homeworkers often enlist their children to help them, violating child labor laws and creating a stressful home environment. AFL-CIO officials complain that labor and civil rights laws can't be enforced in private homes, and that sexual harassment is more likely to occur. Such assertions have little basis in fact or common sense, but they do make good headline copy.

Neither Bill Clinton—nor his new Secretary of Labor, Robert Reich—has yet said how he'll lean on the homework issue. But the betting is the union representatives will get a very sympathetic hearing. "This is a major issue for the unions," says a former labor official. "How can Clinton ignore them?"

Carol Roberts fears the unions will get their way. As an insurance policy, she is trying to develop her own knitting business, Mirjama Knits. When she isn't knitting for the distributor who buys her output, she knits and sells her own designs directly to retailers. If Roberts can get her sideline business going, then as a proprietor she can work wherever she wants.

"I just want the government to leave me alone," says Roberts. With lots of government interventionists taking up residence in Washington, she's unlikely to get her wish.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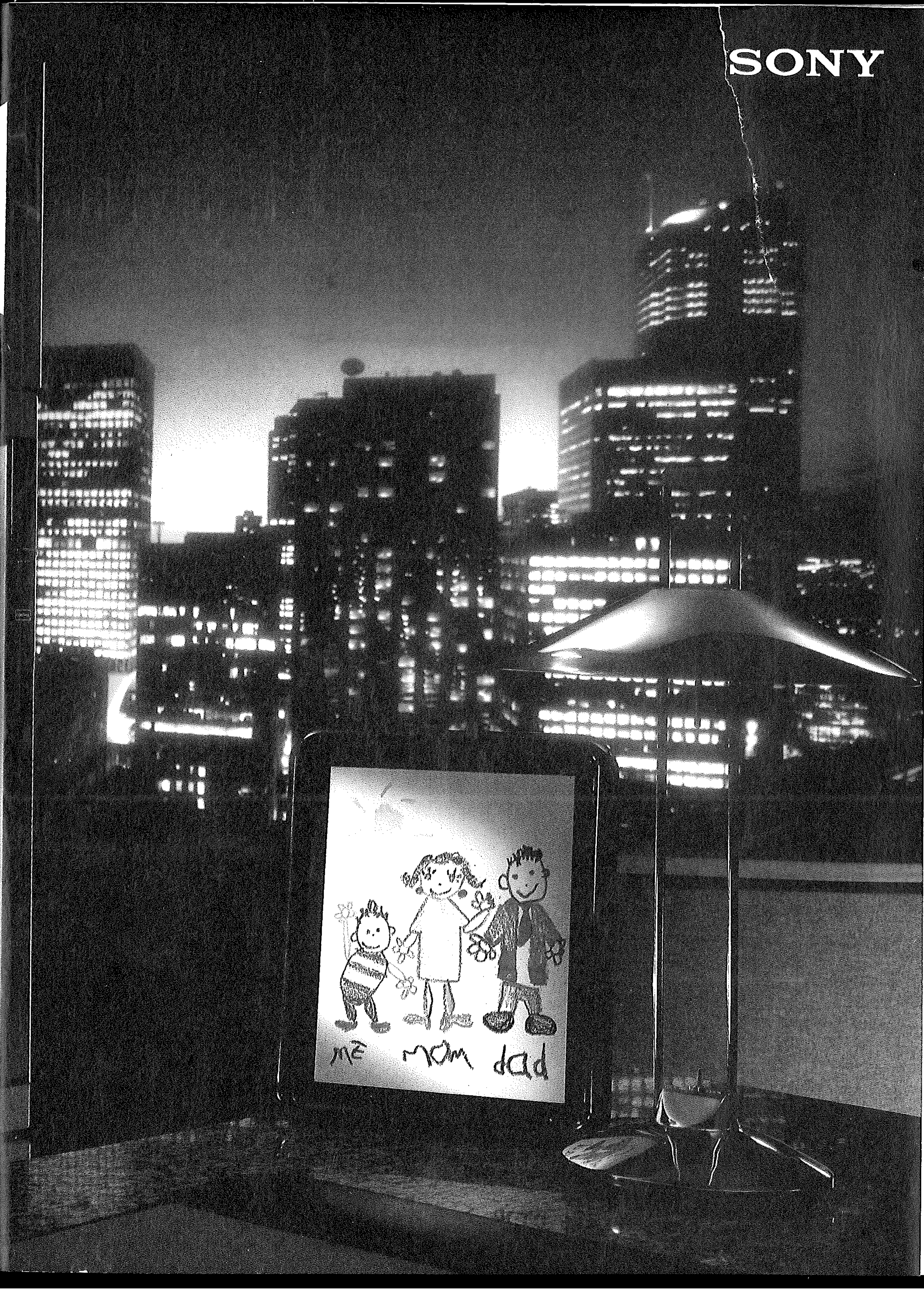
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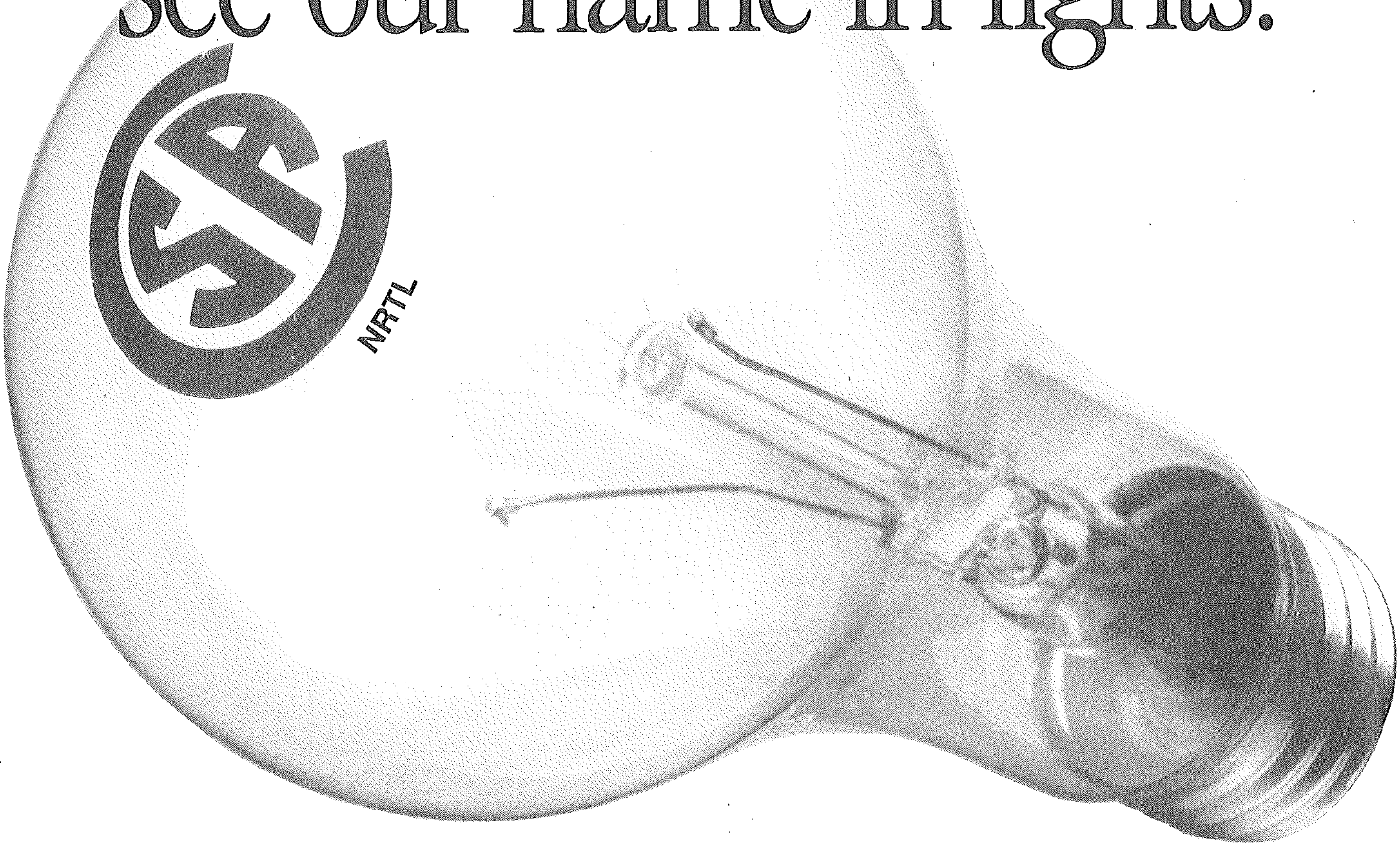

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Making Our Mark on the World

*As referenced to the U.S. Federal Register Vol. 57 #248 57-FR-61452

David McMurtry didn't have enough confidence in his invention to quit his job to promote it. Fortunately for McMurtry—and for Britain—a co-worker did.

The reluctant entrepreneur

By Peter Fuhrman

DESPITE BRITAIN'S well-publicized economic woes, you can't write off the old British lion yet. Not so long as it breeds companies like David McMurtry's Renishaw Plc. From its base in the English Cotswold village of Wotton-under-Edge, Renishaw is the world's leading supplier of a measuring device that makes machine tools accurate to within five-thousandths of an inch (0.005 inches), reliably and consistently.

Renishaw's product is a stunningly simple device that acts as the eyes and fingertips of the tool, while getting round the key problem of metrology, the science of measurement. Usually, as soon as an instrument touches the object being measured, it tends to move it, even if only minutely, making the measurement inaccurate. Lasers often don't work well, either, on a machine shop floor, because cutting oils and metal shavings upset their precision.

At the heart of a Renishaw device is a small, rugged, ruby-tipped probe that is fitted to the cutting end of a computer-controlled machine tool. Customized software allows the probe not only to measure size to microscopic standards but also to check shape and surface finish while the part is being machined.

Prior to the invention of the Renishaw probe, in the mid-1970s, a machinist had to remove each part from the machine tool and measure it on a separate machine, shuttling back and forth until the part finally met the specifications.

David McMurtry had his flash of inspiration one weekend. An amiable 52-year-old who still has a faint lilt from his native Ireland, he was then deputy chief designer at Rolls-Royce Plc., the British aircraft engine maker, where he started work as a 16-year-old apprentice. While working on the supersonic engines used on the Concorde, he faced an awkward problem. Every time the location of a length of tubing along the afterburner was measured, the tubing was knocked very slightly out of alignment, harming the engine's performance.

Malcolm Fielding

David McMurtry, chairman and inventive force of Renishaw Plc. **Winning Japanese respect, the hard way.**

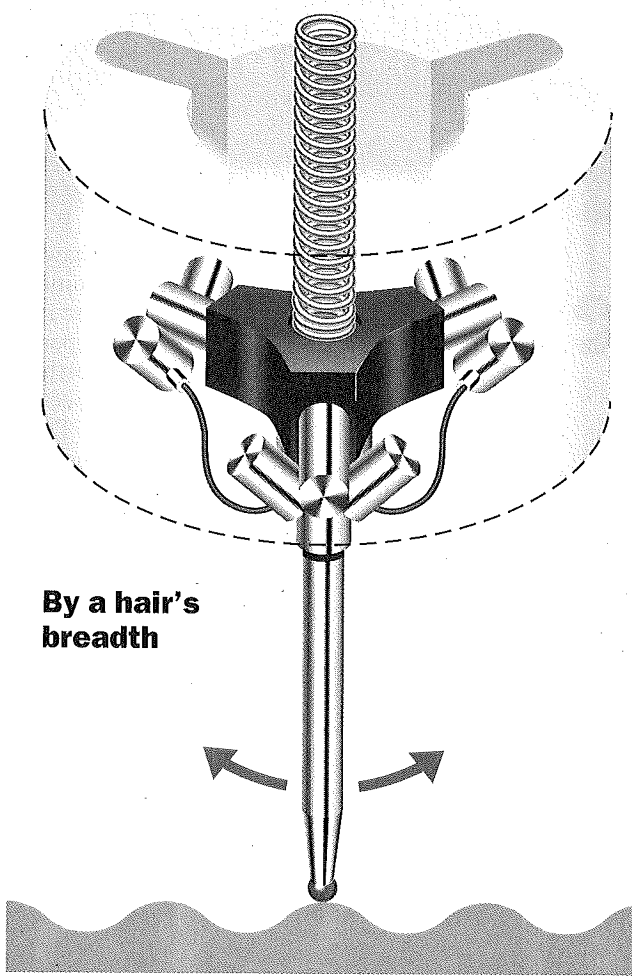
"I went home and built a model of a new type of measuring device using some old metal bits and some carpet underlay," he recalls. How it works—and how it avoids moving the part it is measuring—can be seen in the drawing here.

In a little over a decade, Renishaw probes have become universally used in advanced engineering. NASA uses one to ensure the fit of heat shields on the space shuttle. GM relies on them to guide the cutting of key parts such as engine blocks produced at its Saturn factory.

"If you read a Lexus ad, it stresses how quiet the engine is and how tight the doors fit," McMurtry says. "This is the result of machining parts to within very low tolerances, with no sloppy fits." Using Renishaw probes, needless to say.

He won that respect the hard way. Japan has eight of the world's ten largest machine tool companies and did not take easily to being dependent on a foreigner. While stalling his Japanese patent application for 11 years, Japanese companies made and sold duplicates of the Renishaw probe.

By a hair's breadth



Andy Christie/Forbes

The ingenious Renishaw probe is set among three electronic sensors that register the faintest contact with the piece being measured, whether the pressure comes slightly sideways or vertically. Conventional measuring instruments detect only vertical contact and, as a result, tend to move the workpiece, thereby making the measurement imprecise.

The elegant simplicity of McMurtry's invention made reverse-engineering it all that much easier. The Japanese apparently felt that a little British outfit would have neither the stomach nor the money to fight patent cases in Japan. But McMurtry had the financial backing of his old employer, Rolls-Royce Plc.; McMurtry had granted Rolls a 50% share in his royalties in return for the big company's promise to finance his patent protection.

With Rolls-Royce's support, Renishaw spent more than $4 million in outside legal fees to fight and win 12 major patent suits. Finally Japanese imitators were being forced to cease making their ripoff models, and so were GTE in the U.S. and Carl Zeiss in Germany.

The key legal decision, in 1979, was winning a U.S. patent, thus preventing Japanese companies from selling their knockoffs in the U.S. market. Thus, for all the respect the Japanese now accord him, McMurtry remains somewhat standoffish where his Japanese customers are concerned. He turns down the politest request from Japanese customers to tour the factory. "Why," he asks, "should I give them any ideas about how to compete with us?"

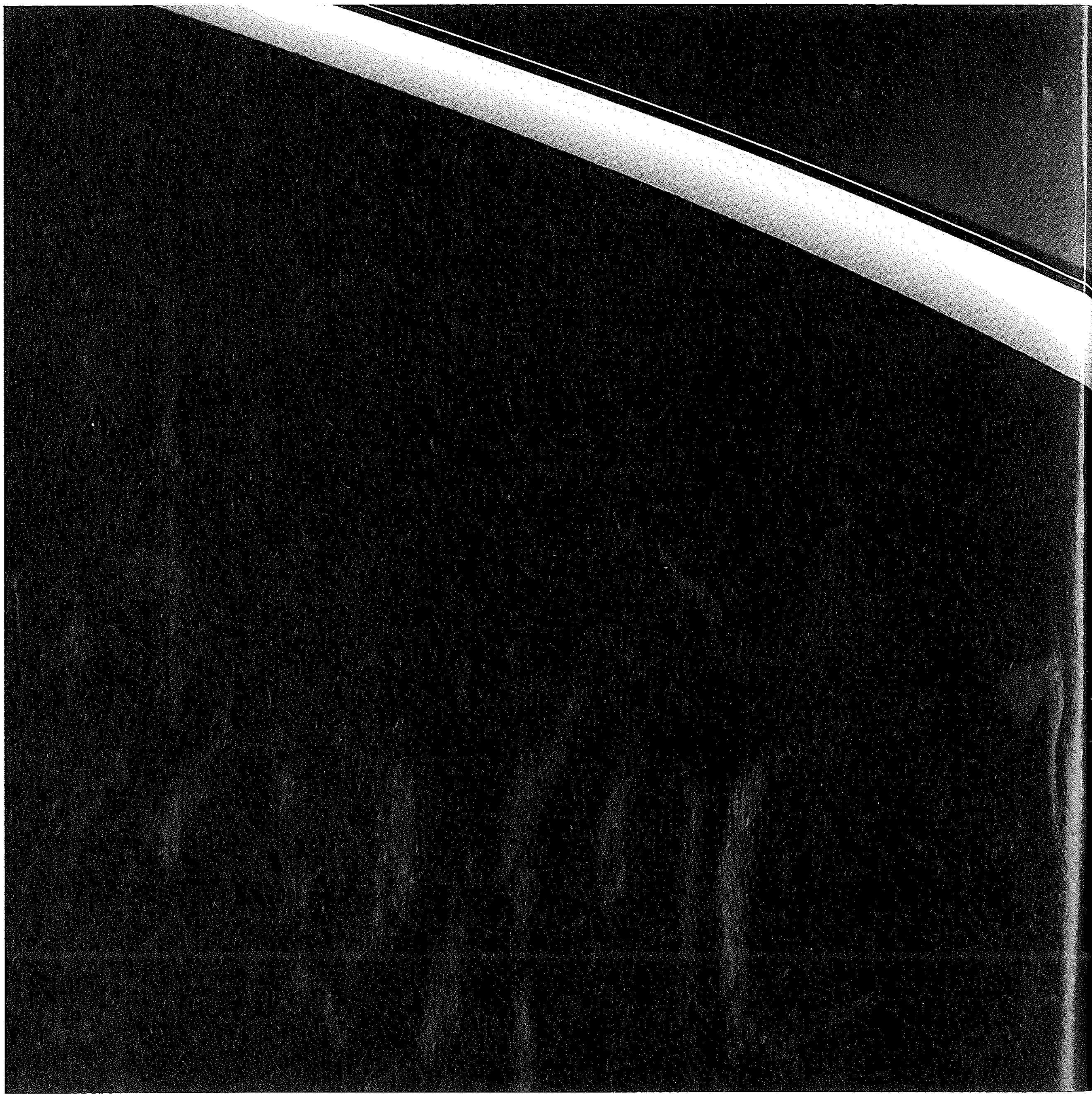
The year Renishaw won its U.S. patent, its sales were just $1.5 million. As the company won the patent suits and put its competitors out of commission, revenues climbed to $43 million by 1988 and $70 million last year. In 1988 Renishaw bought back Rolls-Royce's royalty participation for $2 million.

Its profits are strong, too. The average aftertax profit margin in the U.S. machine tool industry is under 3%. Renishaw makes over 14%, despite current weakness in machine tool orders. The Renishaw probe is contributing to another trend, a noticeable shift by users to buying cheaper machine tools; advanced machine tools cost around $50,000 on average today, down from $80,000 five years ago. The reason: Fitting a probe and its control boxes makes the performance of all lathes, milling machines or drills more or less equal.

Some of McMurtry's original patents begin expiring in three years. He and Renishaw's engineers continue to tinker, however, developing new ideas and more elaborate versions of the probe and its related black boxes. The company has filed 31 new patents in the last year alone. Renishaw has developed an integrated system using a variety of interchangeable probes and software that can cost up to $60,000. Attach one of these to even a standard machine tool, McMurtry says, and a customer can feed raw metal in at night, and return in the morning to find fully machined, quality-inspected parts.

Renishaw has made McMurtry rich. His 35% holding in the London Stock Exchange issue has a paper value of $70 million. The irony is that when he first made his invention he had so little confidence in it he stayed with his job at Rolls-Royce for two more years to finish up his work on the Concorde. Fortunately, a coworker, John Deer, was willing to leave Rolls-Royce and sell the probe full time. Deer is now the deputy chairman and owns 17%, worth $35 million.

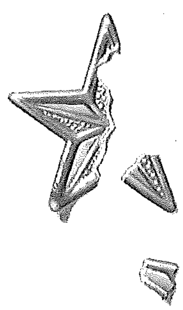

TUTUM TE SISTAM



President Clinton complained about "quota games" and "bean counters" when people criticized the composition of his Cabinet. Welcome, Mr. President, to a problem that you now share with millions of your fellow Americans.

When quotas replace merit, everybody suffers

By Peter Brimelow and Leslie Spencer



Marvin Mattelson

"Quota games . . . math games . . . bean counters!"

President-elect Bill Clinton had every reason to lash out at feminist groups at his Dec. 21 news conference. In fact, he had been bean-counting busily himself: According to widespread reports, some of his original Cabinet picks were bumped because they were the wrong sex or race, key constituencies like urban Catholics and supporters of Israel have been crowded out, and his entire appointment process has been seriously slowed. But now mindless feminist pressure was forcing him to admit the ultimate contradiction of all such affirmative action policies: "Diversity" can conflict with merit.

Above all, the President must know the issue is death for the Democrats: His own pollster, Stanley Greenberg, conducted the post-1984 focus group interviews that found opposition to quotas was key to the defection of white working-class voters. (The party promptly suppressed Greenberg's report and now uses only happy-talk such as "looking like America." But a quota by any other name is still a quota.)

If quotas are clogging the Clinton transition, what are they doing to the economy? The subject went unmentioned, needless to say, at Clinton's two-day economic summit in Little Rock. In fact, it has gone virtually undiscussed throughout the quarter-century of bureaucratic and judicial decrees that have effectively transformed the color-blind 1964 Civil Rights Act into a pervasive quota system.

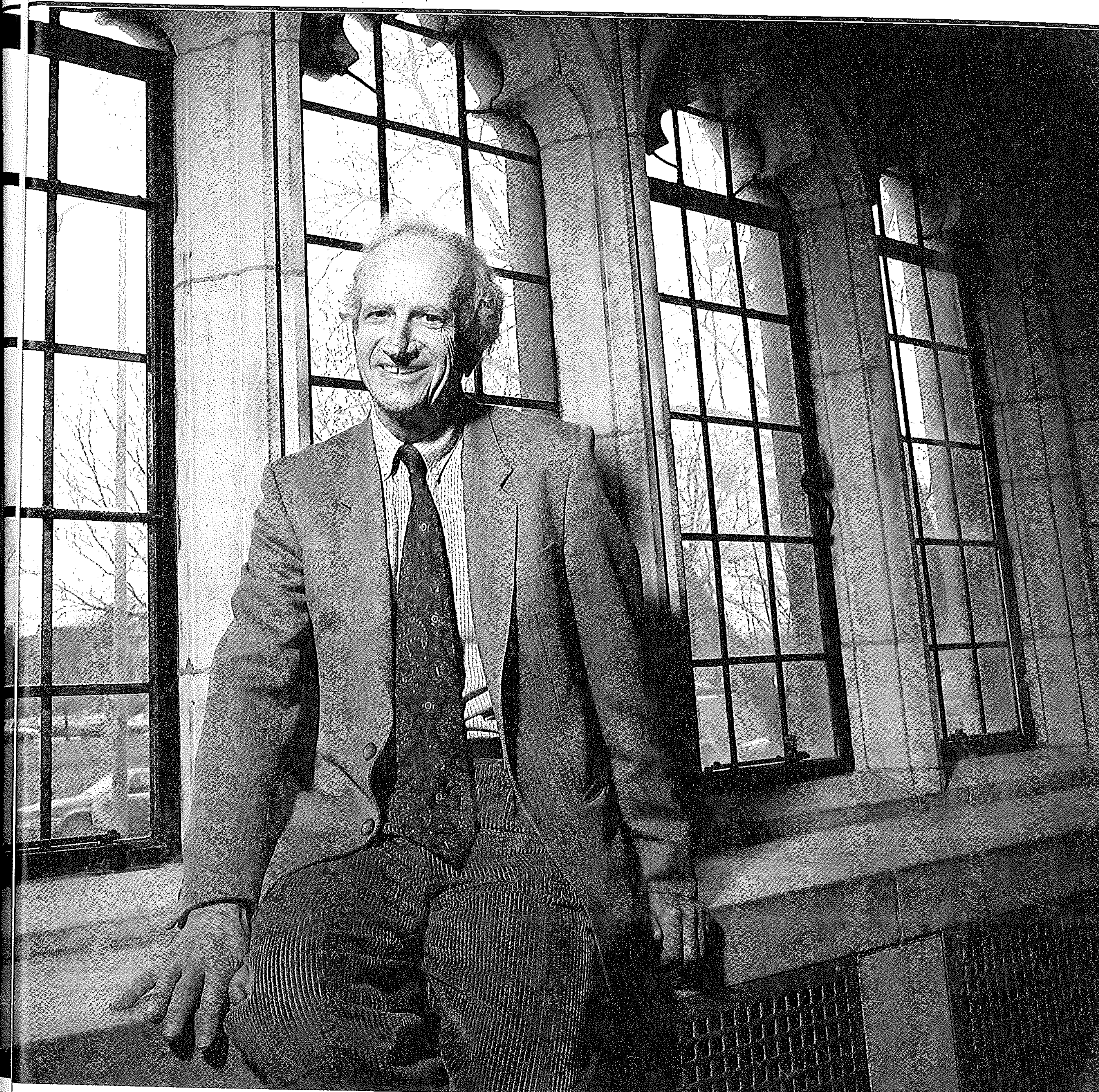
Ironically, just as socialism has collapsed across the globe, the leading capitalist power has adopted a peculiarly American neosocialism, putting politics (and lawyers) in command of its workplace, albeit on the pretext of equity rather than efficiency. Says Edward Potter of the Washington, D.C.-based Employment Policy Foundation: "We have, without doubt, the most far-reaching equal employment laws found anywhere in the world."

Before applauding Potter's sweeping statement, stop for a minute and ponder this question: What does the replacement of merit with quotas cost the American people? The answer is: plenty. The impact may easily have already depressed GNP by a staggering four percentage points—about as much as we spend on the entire public school system.

Quotas are not the law of the land, exactly. They are explicitly banned in both the 1964 and 1991 Civil Rights Acts. Nevertheless, corporate America has been terrorized by the legal legerdemain whereby any statistical disparity between work force and population is equated with intentional discrimination. Throughout American business, newly entrenched affirmative action bureaucrats are enforcing discrimination by race and sex—in favor of the "protected classes" (women, minorities and, most recently, the disabled)—as decreed by

Gary Becker, 1992 Nobel laureate in economics, University of Chicago

"Competition forces people to face costs, and therefore reduce the amount of discrimination when compared with monopolistic situations."


Alice Q. Hargrave

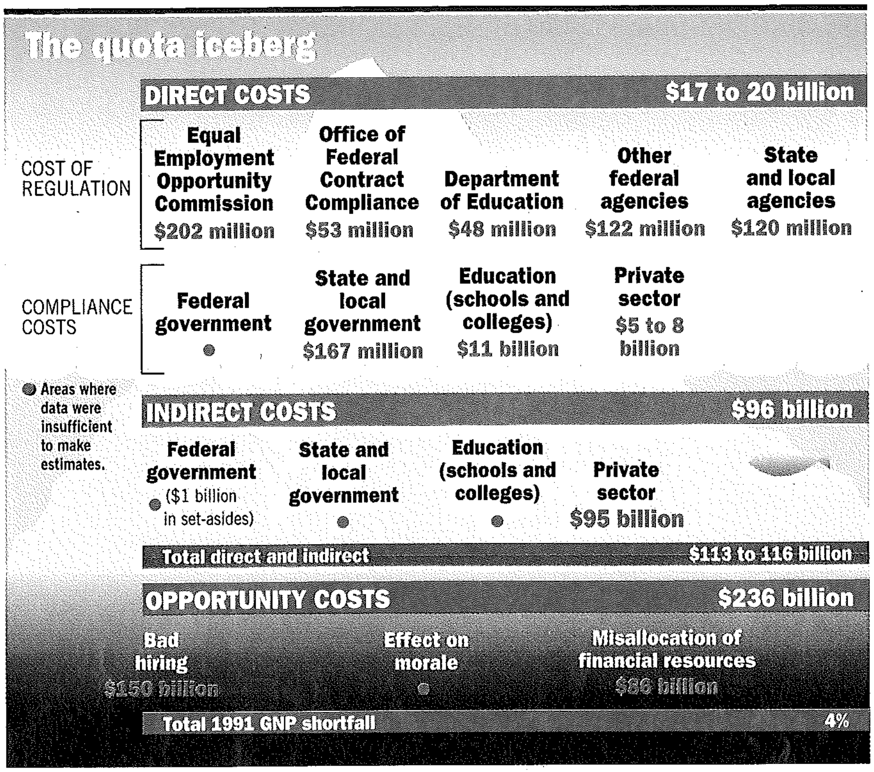
Washington.

One such bureaucrat, Xerox Manager of Corporate Employment Theodore Payne, puts it bluntly: "We have a process that we call 'balanced work force' in Xerox, everybody understands that, and it's measurable, it's goals. . . . *Relative numbers. Relative numbers. That's the hard business, that's what most people don't like to deal with, but we do that all the time.*"

"Balanced work force" is, of course, yet another euphemism for quotas. Payne is apparently saying that Xerox discriminates against white males in favor of the "protected classes." He says it without apology. But, if anyone cares, white males have feelings (and families to support), too.

"To cut whites out of the entire process is racism pure and simple," laments a white male reporter for the *San Antonio Light,* which is due to close down any day. He says Gannett and other major news organizations are showing interest in his Hispanic colleagues exclusively. But he adds: "I don't want to be quoted. I'll never find another job if I am."

In a blistering 1987 article in *Society* magazine, the late Professor William Beer of Brooklyn College described his fellow social scientists' attitude to affirmative action as one of "resolute ignorance." FORBES' search of academic journals and Ph.D. theses confirms that ignorance has remained resolute. What little work has been done tends to focus only on whether



Direct dollars spent on "civil rights" law enforcement and compliance is only the tip of the quota iceberg. Below water, the indirect costs—resources diverted from other activities—are even larger. And this causes an accumulating GNP shortfall.

affirmative action policies have benefited the "protected classes." (Have they? For an answer, see below.)

Corporate America contributes to this resolute ignorance by declining to disclose its costs. "Our members would never say," the National Association of Manufacturers' Diane Generous predicted (rightly). "They would be concerned they might be accused of complaining about how much money they had to spend on this."

Another big business lobby, the Business Roundtable, did publish a study by accountants Arthur Andersen more than a decade ago on how much its members spent to comply with federal regulation, including specifically the Equal Employment Opportunity Commission (EEOC). But today a Roundtable spokeswoman says the organization has no plans to update the study—and that it no longer even possesses any copies.

Sure, measuring the costs of regulation is difficult. But it can be done. For example, the Environmental Protection Agency is required by executive order to make regular estimates of its economic impact.

So here is a rough but reasonable try at figuring the cost of quotas. That funny noise you hear from now on is economists gritting their teeth. Our response to them: Go make your own estimates. And remember—the truth shall set you free.

Two points about quotas emerge immediately:

Quotas are a very big deal. All employers with more than 15 staff, public, private or nonprofit, come under the EEOC's Uniform Guidelines on Employee Selection Procedures. All can be sued by the EEOC for "discrimination" if the racial, ethnic and sex mix of new hires diverges sufficiently from that of all other qualified applicants—for example, if the percentage of blacks hired is lower than the percentage of blacks applying. That covers 86% of the entire nonfarm private-sector work force.

Additionally, more than 400,000 corporations doing business with the federal government, covering about 42% of the private sector work force, have to file with the Office of Federal Contract Compliance Programs (OFCCP). This process is so onerous that the OFCCP's explanatory manual is about 700 pages long. Corporations with contracts of $50,000 or more must develop an "affirmative action plan" aimed at achieving staffing at all levels that is proportionate to the composition of the qualified work force.

Many colleges and universities are subject to no fewer than three federal agencies: EEOC, OFCCP and the Department of Education's Civil Rights Office. And finally, there are federal, state and local governments. Here a racial and gender spoils system has effectively subverted the merit hiring rules so painfully established by Progressive Era reformers at the beginning of the century.

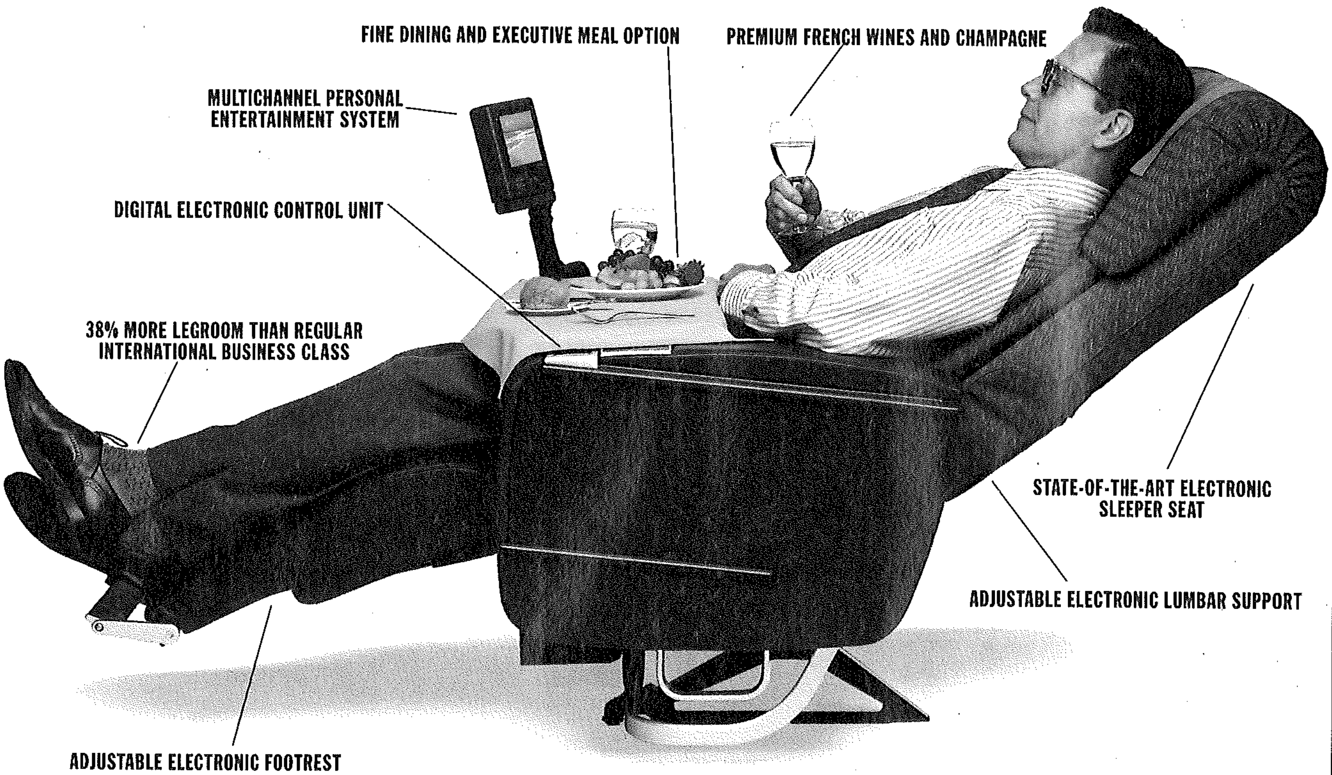
All of which means that the 1984 poll that found one in ten white males reporting they had lost a promotion because of quotas was quite possibly accurate. Indeed, it could be an underestimate. Quotas have been implemented with extraordinary secrecy and deceptiveness, in part because of their dubious legal status.

"Word comes down, but it does not go out," says Claremont McKenna College sociologist Frederick Lynch, author of the only study on the impact of quotas on white males, *Invisible Victims.* He cites a Los Angeles manufacturer whose receptionist was instructed to accept but quietly shelve employment applications from whites and Hispanics—after they had left the room—because the plant did not have "enough" blacks.

Typical of the secrecy and scale of quotas: the "race-norming" saga. EEOC Vice Chairman R. Gaull Silberman—a Reagan appointee—says that until she read it in a newspaper in 1990, she and EEOC Chairman Evan Kemp had "absolutely no idea" that their own agency was pressing for aptitude tests to be race-normed. This bit of bureaucrat-speak refers to the practice of radically adjusting scores to compensate for minorities' systematically lower results. Yet race-norming had been going on throughout the 1980s. It reportedly subjected at least 16 million test-takers to a quota system they knew nothing about.

After public outcry, race-norming was banned in the 1991 Civil Rights Act. But quotas, like vampires, have

THE DIFFERENCE



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proved virtually impossible to kill. Now they seem to be rising from the grave in the shape of a new test-twisting technique called "banding"—concealing differences in performance by lumping ranges of scores together.

The second point about quotas:

Quotas are very expensive. There's surprising denial about this. University of Chicago free market economist Gary Becker, a 1992 Nobel laureate, wrote the standard analysis, *The Economics of Discrimination* (1957). But Becker recently shrugged off affirmative action in a *Business Week* column. He argued that although affirmative action "does hurt some individuals, as it caters to minorities with political clout," it "probably causes less harm than many other programs," such as farm supports.

Strangely, however, Becker tells FORBES that in fact he has no idea what quotas cost ("I think it's an important subject for research"). But we do know what farm supports cost: about $9.7 billion in 1992, which is substantially lower than our estimate of $16 billion to $19 billion for private-sector and education compliance costs alone *(see p. 82)*.

Nevertheless, Becker's analysis of discrimination remains the best framework for assessing the economic impact of quotas:

In a free market, Becker argued, there is an inexorable tendency for everyone to receive the marginal value of his or her labor. This means that ultimately, you are likely to be paid something like what your work is worth. If you belong to an unpopular group, employers may pay you less. But that means that they will make more money off you. Because you are such a profitable hire, you will come into demand, and your labor will be bid up. This process can only be prevented by monopoly or government intervention—both of which happened, for example, in South Africa under apartheid. And now in the U.S. under affirmative action.

Alan Farkas

Theodore Payne, manager of corporate employment, Xerox Corp. **"Relative numbers—that's what most people don't like to deal with, but we do it all the time."**

Talking to FORBES, Becker is very anxious to stress that he is *not* saying discrimination will be *completely* competed away. But there is a *tendency* for it to be competed away. "Competition forces people to face the costs, and therefore reduces the amount of discrimination, when compared with a monopolistic or noncompetitive situation," Becker says.

If you believe that racism stalks America like the Angel of Death and that only federal force can keep it in check, you won't like what Becker is saying. But the evidence clearly supports him.

"Once adjustments are made for factors like age, education and experience, 70% to 85% of the observed differences in income and employment between the various groups in America disappears," says economist Howard R. Bloch of George Mason University. "That's been shown by studies dating back to the mid-1960s. And you can't even be sure that the residual gap is due to discrimination. It could be due to factors we haven't controlled for."

Indeed, Harvard economist Richard Freeman found blacks and whites with the same backgrounds and education had achieved wage parity by 1969, well before quotas had America in their grip.

Even the recent much-touted Federal Reserve Bank of Boston study claiming to prove the existence of racial discrimination in mortgage lending turns out to have made a basic methodological error in its handling of default rates (FORBES, *Jan. 4*). Perhaps significantly, its coauthor, Boston Fed Research Director Alicia H. Munnell, was a featured speaker at the Clinton economic summit.

All of which shows the fallacy of two common arguments for government-imposed quotas: that they are necessary to force corporations to tap new pools of labor, and that corporations need a diverse work force to service an increasingly diverse population. Both simply assume that markets don't operate—that corporations couldn't figure this out themselves.

In fact, it's hard to see any benefits contributed by quotas to the overall economy—as opposed to the benefits they channel to the "protected classes." "Affirmative action is a fairly pure form of rent-seeking," says the University of Arizona's Gordon Tullock, using the concept he developed for special interests' use of political power to extract subsidies for themselves from the economy. "There simply isn't any other economic rationale."

"In 1987 EEOC's local field office wrote me a letter saying they had reason to believe I didn't have enough women 'food servers' and 'busers.' No woman had complained against me. So the EEOC advertised in the local paper to tell women whose job applications we had rejected—or even women who had just thought of applying—that they could be entitled to damages. Twenty-seven women became plaintiffs in a lawsuit against me. The EEOC interviewed me for hours to find out what kind of person I was. I told them in Sicily where I came from I learned to respect women. I supplied them with hundreds of pounds of paper. I had to hire someone full time for a year just to respond to EEOC demands. Six months ago I finally settled. I agreed to pay $150,000 dam-

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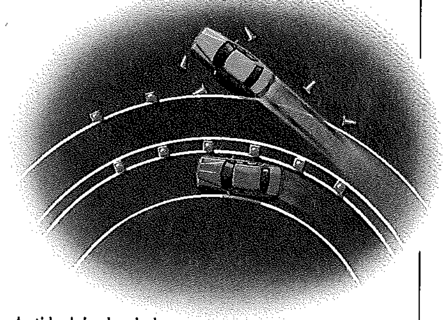

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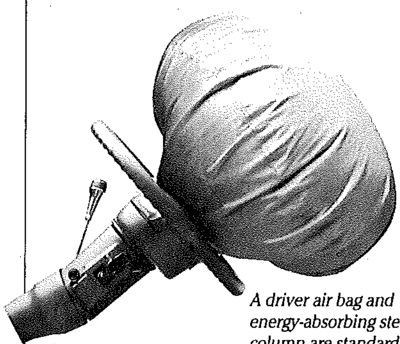

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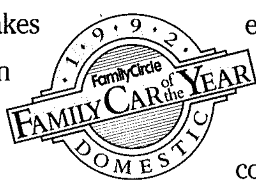

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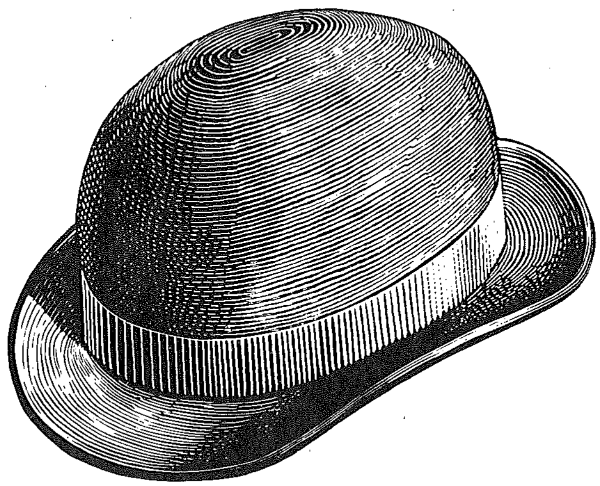

Sam Kitner

R. Gaull Silberman, vice chairman, Equal Employment Opportunity Commission

Silberman says "race-norming" of aptitude tests was news to her, although her agency had been encouraging its use for a decade.

ages, and as jobs open up, to hire the women on the EEOC's list. Even if they don't know what spaghetti looks like! I have to advertise twice a year even if I have no openings, just to add possible female employees to my files. I also had to hire an EEOC-approved person to teach my staff how not to discriminate. I employ 12 food servers in these two restaurants. Gross sales, around $2 million. How much did it all cost me? Cash outlay, about $400,000.

What the government's done to me—devastating. I wouldn't wish it on my worst enemy."

—Thomas Maggiore,
Owner of Tomaso's and
Chianti restaurants,
Phoenix, Ariz.

Economists break the cost of regulation into three parts:

Direct Costs: the EEOC's outlay of taxpayers' money in regulating and suing Thomas Maggiore, and the money he spends in fines, damages, filling in forms, advertising and otherwise complying with EEOC demands.

Indirect Costs: the time and overhead Maggiore has to divert from other activities to argue with the EEOC, do the continuing paperwork, sit through sensitivity training, reorganize his workplace and his methods of operating.

Opportunity Costs: what Maggiore might have achieved if he had been allowed to invest his time and money as he wanted; the loss to the Phoenix-area economy if he gives up and goes back to Sicily.

Remember: Thomas Maggiore is precisely the kind of small business person the politicians claim they want so badly to help.

Let's look at some numbers.

Direct Costs. One guess of private sector compliance costs for affirmative action: In 1977 Business Roundtable members spent $217 million complying with equal opportunity regulations. They employed 5% of the nonfarm work force; OFCCP regulations cover 42% of the private workforce, implying total costs of $1.8 billion. Adjusted for inflation, that's a current $4.2 billion.

Second guess: In 1981 a study by the Senate Labor & Human Resources Committee suggested compliance costs for the largest 500 companies of about $1 billion. That's $1.8 billion extrapolated over the OFCCP universe. Adjusted for inflation: $2.8 billion.

Neither of these figures includes the EEOC's impact, although it is by far the larger bureaucracy. But the guesstimates are in line with the rule of thumb developed by regulation-watchers from the Center for the Study of American Business at Washington University in St. Louis: Every dollar spent on regulatory enforcement inflicts about $20 in compliance costs. By FORBES' count, the federal government spent some $425 million on civil rights oversight in 1991, of which about $303 million appears to be directed at the private sector. Implied private-sector compliance cost: $6 billion.

You Don't Go Back To Basics. You Take Them Forward.

There is a curious shift in business these days, "back to the basics." And it seems as if the sophisticated fast-trackers of the '80s have been transformed into the business fundamentalists of the '90s.

Nice try, guys. The simple truth is, basics are something you start with and take forward. Not retreat to.

Over the past 11 years we've become a financial services company with $15 billion in assets under management. We've grown by embracing the ageless basics of common sense and simplicity and bringing them into a new age of technology and management.

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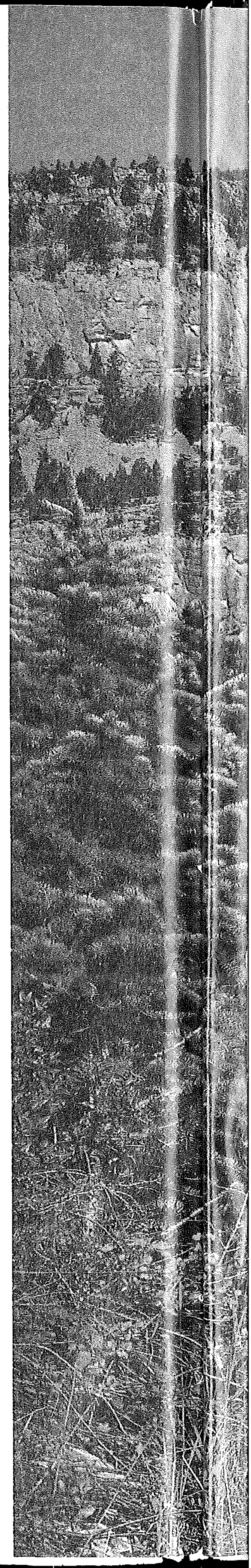
The basics. By taking them forward, they've taken us forward. To where we are today, to where we'll be tomorrow.




Conseco

To get an estimate of compliance costs in colleges and universities, FORBES turned to John Attarian, a writer and economics Ph.D. who has analyzed the budget of his alma mater, the University of Michigan. Under its "Michigan Mandate," the university is devoting much effort to the recruitment and retention of the "protected classes."

Attarian says about 2.5% of the University of Michigan at Ann Arbor's general budget appears to be devoted to this cause. This does not capture costs buried in department budgets, such as for recruitment. (Minor example: Advertising faculty posts in special minority-oriented publications costs over twice the usual rate.) Still, extrapolated across the estimated $164 billion spent on U.S. higher education in 1992, this suggests total compliance costs of $4.1 billion.

If the same relationship holds true for the $261 billion spent on public and private schools in 1992, their compliance costs would be $6.5 billion. Of course, the problems of schools are different from those of colleges. They may be worse. Busing for racial balance has reportedly caused some school districts to spend over a quarter of their budgets on transportation.

Quotas are just another excuse for the American academic establishment to eschew scholarship for social engineering. Thus, a long survey of "minorities in science" in the Nov. 13 issue of *Science* magazine reported that the National Science Foundation, which is supposed to be funding research, has spent a staggering $1.5 billion in the last 20 years on fostering black scientists. The magazine describes the results as "dismal."

State and local governments also face compliance costs—and they also inflict them on the private sector. New York State, for example, spent $10.5 million complying with its own and federal laws last year, and $7.5 million on "civil rights" enforcement. In 1990 state and local governments spent some $835 billion. Implied total expended on quota compliance and coercion, given New York's rate: $287 million. Additional private sector compliance costs, given New York's enforcement costs and applying CSAB's 20-to-1 rule of thumb: $2.4 billion.

Note that we include no estimate of what it costs the federal government to comply with its own regulations.

We like to be moderate.

Private-sector compliance costs are apparently much exacerbated by the federal enforcers' arbitrary and erratic behavior. Some rare case studies appeared in the September 1992 issue of the American Academy of Political & Social Science's journal *Annals*. One victim reported supplying documents nine times because the OFCCP kept losing them. Another, the National Bank of Greenwood, Ind.—$117 million assets, 138 staff, full- and part-time—was subject to a grueling and chaotic two-year audit, costing more than $100,000 and 4,000 staff hours, although no complaint had apparently been lodged against it. Later the bank was audited twice more, again apparently without any complaints being lodged. Typically, the Indianapolis-based Merchants National Corp., which has meanwhile taken over the National Bank of Greenwood, refused to allow its officers to talk about the experience.

Sam Kittner

EEOC Chairman Evan Kemp
Bush appointee, critic of quotas.

Total direct costs: $16.5 billion to $19.7 billion. Or about $300 per family of four. Compare it with the $20 billion of "infrastructure spending" Clinton has promised to kick-start the economy. And this is just the tip of the iceberg.

Indirect Costs are the part of the iceberg just under the water—easily-seen but involving no direct cash outlay.

"It takes me 50 extra hours to make every faculty hire because of the need to comply with affirmative action rules," says Professor Herbert London, formerly Dean of New York University's Gallatin Division, "even when I end up hiring the person I wanted to hire in the first place."

Naturally, this cost does not appear as a cash item in NYU's operating budget of $627 million, excluding the medical school. (The two-person affirmative action office costs just $172,000—or about $6.50 per full-time student—although a spokesman tells FORBES that over a hundred people deal with minority recruitment every day.) Nevertheless, the cost is real.

A measure of these indirect costs is provided by the single Ph.D. thesis FORBES found that investigated costs, by Peter Griffin, now assistant professor at California State University at Long Beach. Griffin's rarefied econometric analysis concluded that by 1980, OFCCP regulation had increased federal contractors' labor and capital costs by an average of 6.5%. (As compared with noncontractors—although actually their costs would also have been increased by EEOC requirements.)

The implications of this are substantial. OFCCP regulation covers about 42% of the civilian work force. The contractors' cost of labor alone exceeded $1.4 trillion. The minimum cost of quotas to them, based on Griffin's methodology: about $95 billion—1.7% of GNP.

And the cost to the federal taxpayer is heavy. In 1991, $211 billion was

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expended on federal contracts with non-government entities. The additional costs inflicted by affirmative action regulation that Griffin's work suggests this sum incorporates: some $13 billion.

Which is on top of the damage inflicted on the taxpayer by "set-asides," the reserving of some portion of federal work entirely for contractors from the "protected classes." About $10 billion of federal contract monies were channeled in this way last year. The premium paid is not supposed to go over 10% (although FORBES has heard of premiums as high as 25%). Additional quota tax: perhaps $1 billion.

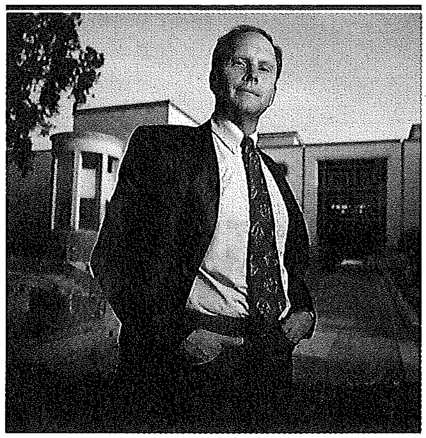
Ironic set-aside fact: The law is confused about this type of quota too. In Richmond v. Croson (1989), the Supreme Court ruled that many of the 234 state and local government set-aside programs were unconstitutional, unless actual discrimination could be proved. Local politicians, anxious to continue handing out the pork, instantly created a minor "disparity studies" industry to make the case that discrimination against minorities was widespread. In a detailed account in the January 1993 issue of *Public Interest* magazine, University of Maryland at Baltimore Professor George La Noue estimates that at least $13 million of taxpayers' money had been fed into this young industry by June 1992, with another $14 million commissioned by the federal Urban Mass Transit Authority alone. Atlanta spent $532,000 for a 1,034-page report coauthored by Ray Marshall, the Carter Administration's Secretary of Labor.

Expensive? Well, proving discrimination is hard work. Most localities have long been legally required to accept the lowest bid—a Progressive-era reform aimed precisely at patronage-hungry politicians. And, significantly, cities like Atlanta, which now want to claim they discriminated, have actually been under black political control for years.

Even more ironic set-aside fact: This type of quota has created another industry—corruption. A prime contractor can set up his black electrician, for instance, in "business" as a purchaser. The electrician needn't have credit or contacts with suppliers. He just takes 5% off the top. One "native American" contractor in Tulsa reportedly had blue eyes and an Irish name but had managed to join the Cherokee Nation of Oklahoma on the strength of an alleged great-great-great-great grandparent.

These abuses can only be checked by more supervision. But minority contractors have been quoted complaining the program is too bureaucratic already.

Astoundingly ironic set-aside fact: According to Professor La Noue, over one-half of the Small Business Administration's set-asides go to groups that are composed largely of first- or second-generation immigrants. He suspects the same is likely to be true for all set-asides. In Washington, D.C.—where an amazing 90% of the city's road construction contracts have been set aside—one of the largest beneficiaries has been the Fort Myer Construction Corp., owned by a family of Portuguese origin who qualify as Hispanics because they emigrated from Argentina.



Ann Summa

Fred Lynch, Claremont McKenna College
White males are "invisible victims."

Absurdly, all immigrants who fall into the "protected classes" qualify for all U.S. quota programs. Which is a pretty clear indication that quotas are not about righting past wrongs at all, but about asserting political power over the economy.

A further indirect cost of the affirmative action system: litigation. (You thought massive regulation would preclude litigation? This is America!)

The number of discrimination suits in federal courts is rising astronomically—by 2,166% between 1970 and 1989, when some 7,500 were filed, versus an increase of only about 125% in the general federal caseload.

Significantly, suits about discrimination in hiring used to outnumber suits about firing. Today it's the reverse, by a factor of three or more. It's obviously absurd to suppose the same employer discriminates in firing but not in hiring. The civil rights frenzy has simply led to a more litigious, as well as politicized, workplace.

Example: Alabama state law required the Lamar County Board of Education to fire a black teacher after she failed a mandatory competency test five times during the three years allowed. She alleged discrimination because the test failed a disproportionate number of blacks. A judge reinstated her with three years' back salary.

And it's going to get much worse. Preliminary reports are that since the 1991 Civil Rights Act and the 1990 Americans With Disabilities Act (which few people yet realize is also a quota bill) filings have jumped some 30%. Both acts for the first time allow punitive damages, an explicit incentive to contingency-fee trial lawyers.

Opportunity Costs are the base of the quota iceberg, down in the murkiest depths. Unlike the direct and indirect costs of regulation, they don't show up in GNP statistics. They represent what GNP could have been if these more tangible costs had been spent differently—for job-creating investment, say, or for education. But these indirect costs are the most massive of all. For example:

Having the wrong people in the wrong jobs. Corporate America seems to have resigned itself to quotas as yet another tax. But they are a peculiarly debilitating sort of tax, levied not on the bottom line but on every phase of the corporation's activities, increasing inefficiency throughout. Most taxes are a burden to be shouldered. This is an enfeebling drug.

That affirmative action quotas lead to lowered standards is all but guaranteed by the fact that all standards are suspect to Equal Employment enforcers. "Many of these people believe there really is no such thing as job performance or productivity objectively defined, that it's really just a

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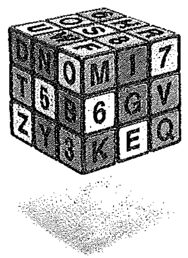
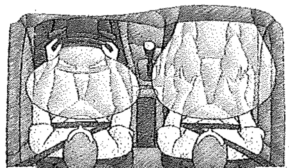


puzzles, the Mazda 929 can anticipate many things you want to do. And then do them for you. ❧ Drive up a steep hill, for instance, and you'll find that the 929 cruise control maintains a steady speed without annoying and unwanted shifts—thanks to its advanced "fuzzy logic" computer, an automotive first. Turn on the windshield wipers when it rains, and the climate control knows to automatically turn on just enough air conditioning to dehumidify the interior. Or park in the sunlight, and an available solar-powered ventilation system knows to activate fans to help cool the cabin. ❧ So while you'll certainly appreciate the 929's V6 power, its sculpted shape, and luxuries such as the available leather trim,* what you may like most is the way this car thinks.



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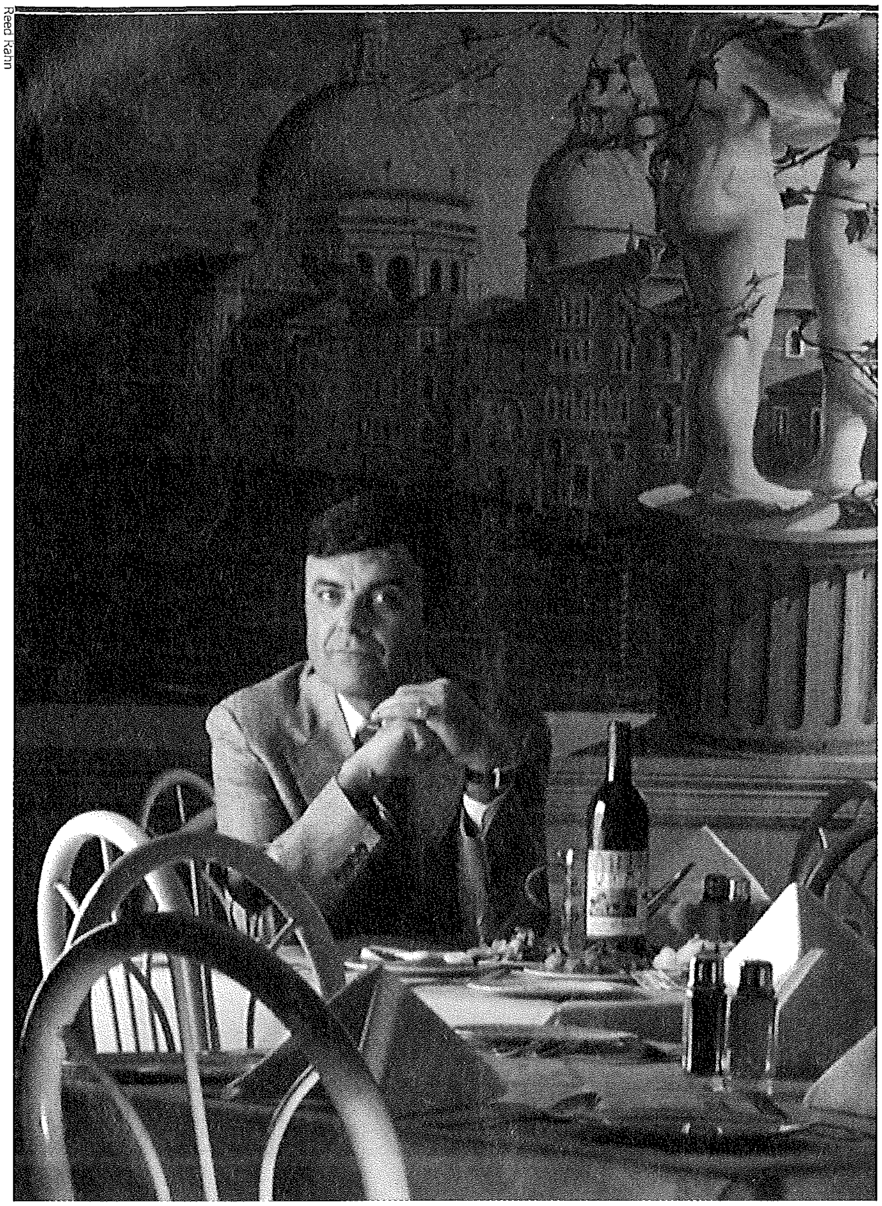
Reed Kahn



Thomas Maggiore, restaurant owner, Phoenix, Ariz.
"I wouldn't wish this on my worst enemy."

matter of one's cultural definition or cultural orientation," says Frank Schmidt, a University of Iowa industrial psychologist. Increasingly, they have been able to impose this view on American business.

The civil rights revolution has also virtually aborted the use of tests devised by industrial psychologists, which in the 1950s promised to make employee selection a science. Tests came under attack because minorities typically scored lower on them. Today they are only used, if at all, after work-related validation studies that can cost millions of dollars.

Industrial psychologists, however, have gone on believing in their work. Schmidt and John Hunter of Michigan State University have produced numerous studies showing that hiring the able results in enormous productivity increases. Today, Hunter estimates that total U.S. output would be about $150 billion higher if every employer in the country were free to use tests and select on merit. That's about 2.5% of GNP.

Effect on morale. Poor hiring shows up not merely in poor decisions but also in poor morale. Quotas, like income tax (and unlike farm supports), have an immediate and dramatic impact on incentives.

Frank Schmidt put it like this: "When the less competent employees reach a critical mass, their lower performance standards become the standards of the organization." The longer-established employees who are equipped for the job abandon their old high standards and conform to the new, lower ones.

Schmidt and Hunter made no estimate of the impact of this phenomenon. But they have speculated that it lay behind the U.S. productivity stall of the 1970s, as the first effects of the war against testing were being felt.

Misallocation of resources. Monies expended to meet the costs of affirmative action cannot be spent on research and development and plant modernization. The effect of this is cumulative: The growth path of the economy diverges, permanently and increasingly, from its potential. Thus we estimate that an extra $113 billion in direct and indirect costs have been inflicted on the economy annually since 1980. A standard calculation converts this into an estimate of GNP shortfall because of affirmative action: about 1.5 percentage points by 1992.

GNP in 1991 was about $5.7 trillion. The total shortfall quotas may already have caused comes to some 4%. That's well over $225 billion, money that could buy a lot of social programs. Or finance a good deal of job-creating investment.

So quotas cost a lot. But do they do any good at all?

Quotas have obviously failed to prevent continuing catastrophe in much of black America. Prevailing taboos make this subject difficult to discuss. But the distressing facts are powerfully summarized in a remarkable new book, Jared Taylor's *Paved With Good Intentions: The Failure of Race Relations in Contemporary America* (Carroll & Graf). In 1950 only 9% of black families were headed by a single parent; in 1965, 28%; now, fully half. In 1959 only 15% of black births were illegitimate; in 1992, 66%. One in four black men in their 20s is either in jail, on probation or on parole. Clearly, affirmative action has done nothing to reverse the dismal trends.

Quotas have not decisively improved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overall black employment. "Despite all the controversies surrounding affirmative action," says Queens College Professor Andrew Hacker, a supporter of quotas, in his bestselling *Two Nations: Black and White, Separate, Hostile, Unequal,* "fewer blacks now have steady jobs of any kind and their unemployment rates have been growing progressively worse relative to those recorded for whites."

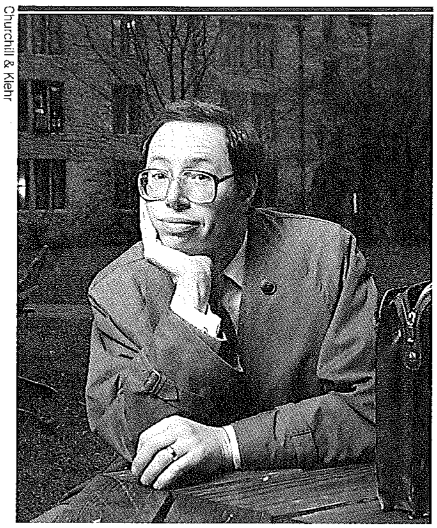
Quotas' effect on black incomes appears at best mixed. Between 1970 and 1990 black median family income, adjusted for inflation, crept snail-like from $21,151 to $21,423. But the proportion of black families earning above $50,000 jumped sharply, from about 10% to nearly 15%. Dragging down the median: the increase in black families receiving below $15,000, now nearly 40%. So quotas may have helped create a black middle class (although educated blacks might have done well anyway; after all, the proportion of white high income families also rose in this period). But the black poor have not benefited.

Quotas in colleges have not prevented the gap between black and white college participation from widening in the 1980s. By 1976 some 22.6% of black 18-to-24-year-olds enrolled in college, compared with 27.1% of whites. Thereafter black participation declined, then recovered. In 1990, 25.4% blacks enrolled, but meanwhile white participation had grown to 32.5%.

And although crude enrollment numbers are dear to the hearts of college admissions officers, they conceal tragic differences in attrition. For example, only 37.5% of blacks enrolling at Berkeley in 1983 had graduated five years later, compared with 72% of whites. Critics argue that top colleges burn out black students by irresponsibly recruiting them to fill quotas, when they could be successful at less high-pressure schools.

Quotas may have improved the status of women—or they may not. It's easiest to show that women have gained in the last decades—ironic, because their plight was hardly as serious as that of blacks, with whom they are now competing. Women's share of professional degrees grew from 2.7% in 1960 to 36% in 1990, and their average earnings as a percentage of men's has increased from 61% to 72% over the same period.

But quotas may not be responsible. Female participation in the work force has fluctuated widely for generations, correlated with demographic factors like marriage and fertility rates. For example, the Hoover Institution economist (and FORBES columnist) Thomas Sowell has noted that women earned 17% of Ph.D.s in 1921 but only 10% in the early 1960s. Amazingly, as long ago as 1879 women constituted 40% of all college faculty and administrators. Many of these colleges were women-only, but they could still be highly competitive: In 1902 the proportion of women listed in *Who's Who* was more than double that in 1958.



Churchill & Klehr

University of Chicago's Richard Epstein
Just give them the money.

This problem of apportioning credit bedevils the whole quota debate and, indeed, the entire subject of government-mandated social change. Looking back on the 1964 Civil Rights Act and its controversial enforcement, the American Enterprise Institute's Charles Murray, author of *Losing Ground* and *In Pursuit,* offers this startling thought: "There's hardly a single outcome—black voting rights, access to public accommodation, employment, particularly in white-collar jobs—that couldn't have been predicted on the basis of pre-1964 trend-lines." That's pretty devastating. It suggests that we have spent trillions of dollars to create an outcome that would have happened even if the government had done nothing.

From an economic standpoint, quotas work rather like an older form of American neosocialism: price and wage controls. They may seem to produce the desired result. But they could equally well just be simulating it, or even smothering it.

Meanwhile, of course, the economy suffers.

It may be that before America can talk rationally about race, the generation that remembers segregation will have to die off. And we're not talking about liberals. FORBES asked Gary Becker, 62, what he thought would be the ideal public policy in this area.

Becker: I prefer to pass on that one. I have views on it, but I don't want to talk about it at this moment.

Oh. Why not?

Becker: Well, let me just make that judgment. I prefer not to.

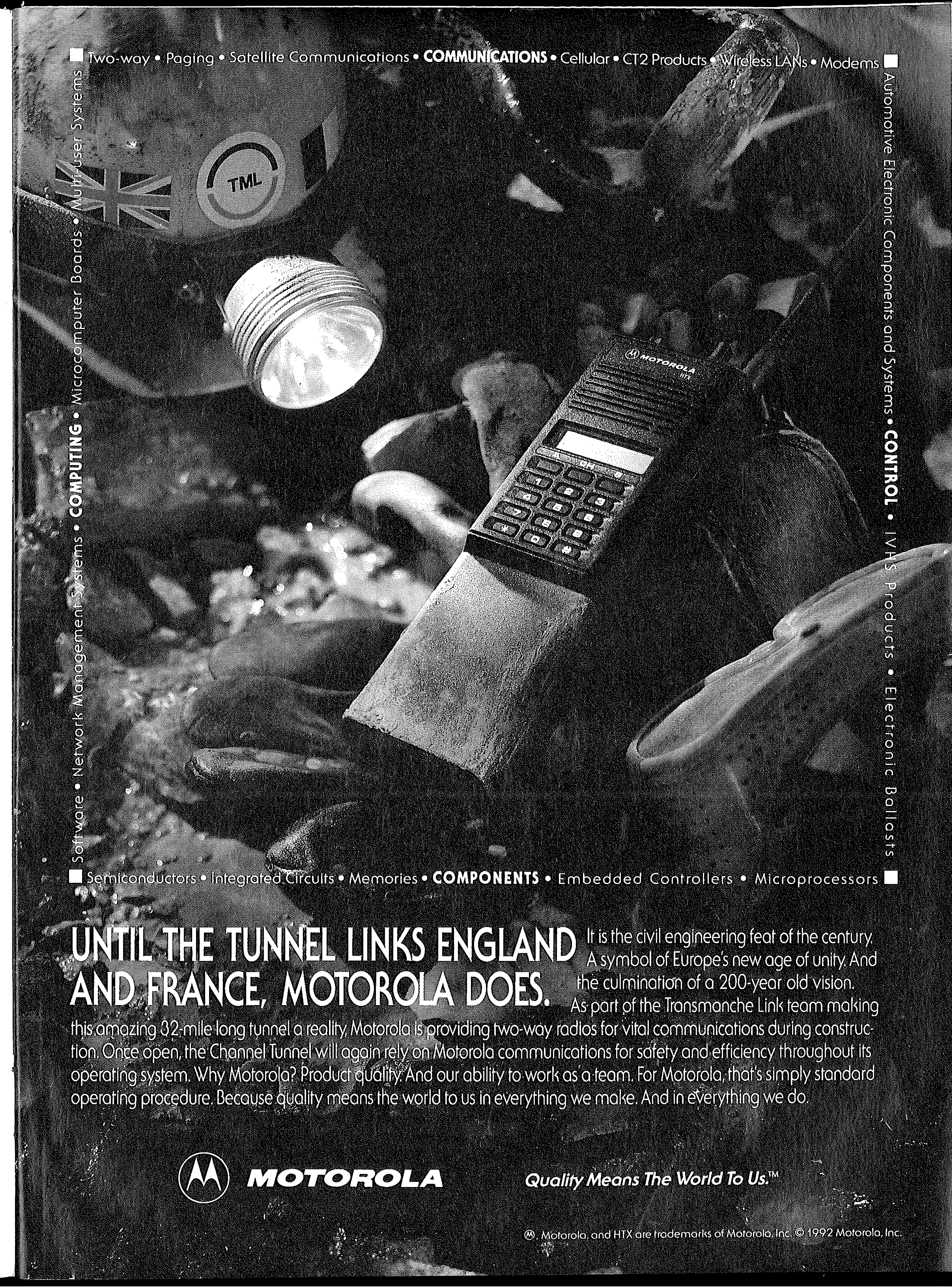
Becker's University of Chicago colleague Richard A. Epstein, 49, seems to be less nervous about his popularity in the Faculty Club. His book *Forbidden Grounds: The Case Against Employment Discrimination Laws* argues that the modern civil rights laws are flawed to their heart because in negating freedom of association they have inexorably led to government coercion that threatens markets and, ultimately, liberty.

"At bottom are only two pure forms of legislation— productive and redistributive," Professor Epstein argues. "Antidiscrimination legislation is always of the second kind. The form of redistribution is covert; it is capricious, it is expensive and it is wasteful."

And Epstein makes the key economic point: If we want to subsidize a "protected class," he writes, it can be done more efficiently by just giving grants.

"I have a dream," Martin Luther King Jr. said 30 years ago, "that my four little children will one day live in a nation where they will not be judged by the color of their skin, but by the content of their character."

As bean-counting has displaced merit in America, that day is further off than ever.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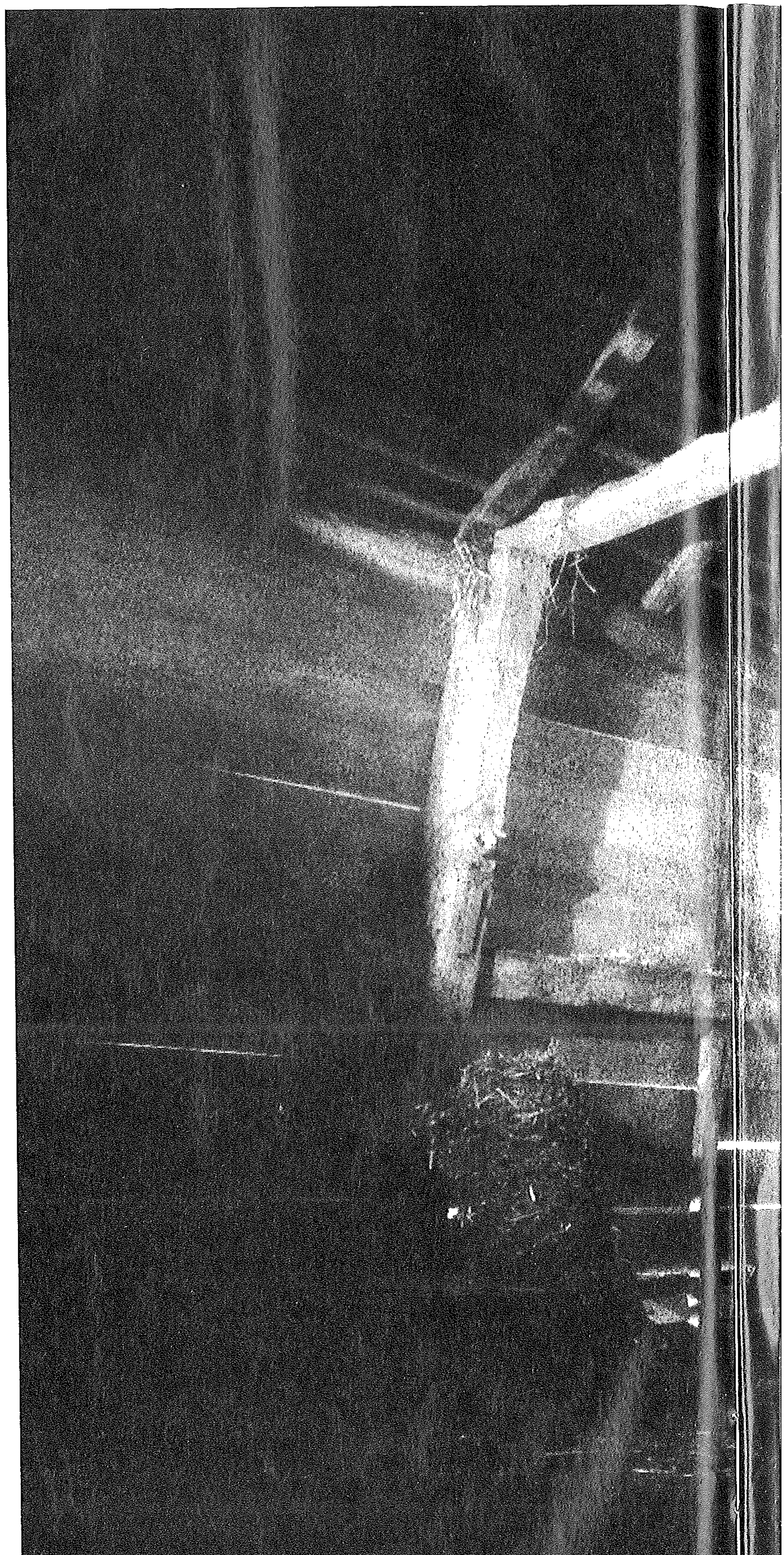
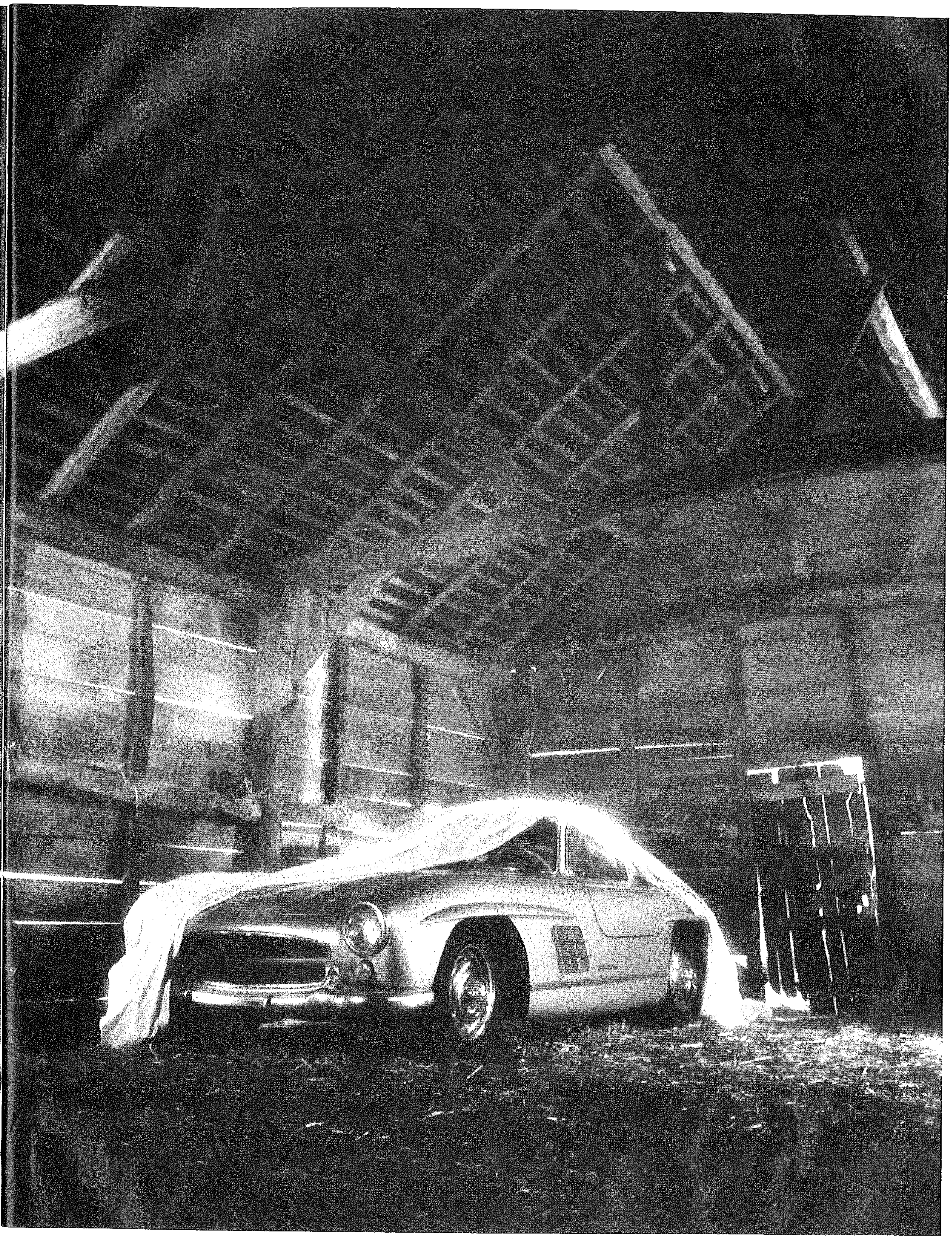




Do you think you can spot a turnaround candidate? Here are some formulas to use in your search.

The dog pound

By Robert Rosenstein

Patrick McDonnell

YOU COULD HAVE made a lot of money buying Chrysler back in 1981, when it was a seemingly hopeless loser. Where does one go hunting for future Chryslers? A computer, by itself, won't pick the right stocks, but it can narrow down the list of turnaround candidates to a manageable few. We've used a stock screening package to kick out the list below of companies that are losing money but could stage a comeback this year.

Our searching rules combine balance sheet items, earnings forecasts from Wall Street analysts and a price ratio popularized by Kenneth Fisher, FORBES columnist and Woodside, Calif. money manager.

Fisher's favorite tool is the price/sales ratio. To get this number you divide a company's market value (price of common times shares outstanding) by its annual sales. Other things being equal, you want a stock with a low PSR, on the theory that profit margins of both good companies and bad companies tend to regress toward the mean. One, not very profitable, paper company may be going for 0.5 times revenues, another for 2 times revenues. If the first gets its costs in line and the second attracts new competition, profits will rise faster at the first.

Take SCI Systems, a manufacturer of electronics and electrical equipment. A year ago SCI showed 12-month trailing earnings of 7 cents a share and traded as low as 6½. At 93 times earnings, SCI certainly seemed no bargain, but looked at another way it was dirt cheap; its market capitalization was only 13% of its revenues. In other words, it had a PSR of 13 cents on the sales dollar, while the average PSR for its industry group was 60 cents on the dollar. Ken Fisher's hunch that cost-cutting would eventually kick more revenue to SCI's bottom line was correct. SCI's 12-month earnings rose to 30 cents a share, causing the stock to triple.

We refined Fisher's ratio by including debt in the price tag affixed to a company. Thus, if the firm's share valuation, debt outstanding and sales volume are each $1 billion, it really costs $2, not $1, to buy $1 of sales revenue at this firm. We call this the "total price/sales" ratio. All of the prospects below show a total PSR of 1.0 or less.

Next, we compared the total PSR to the average ratio for the firm's industry. The result is shown as the "relative PSR"; in all cases this ratio is 1.0 or less. Finally, we limited the list to companies with recognized prospects for a rally in earnings; all are expected to earn money in 1993, according to consensus earnings forecasts. ■

Recovery candidates

Company/business	Recent price	Earnings per share latest 12 mos	Earnings per share 1993 estimate	Estimated 1993 P/E	Price/sales ratio[1] total	Price/sales ratio[1] relative to industry	Price/book[2]	Debt/equity	Latest 12 mos sales ($mil)
Crown Central Petroleum/petroleum refining & marketing	15¼	$-1.81	$1.83	8.3	0.12	0.28	0.49	22%	$1,778
Charter Power Systems/batteries & equip	5	-0.27	0.50	10.0	0.38	0.44	0.94	63	132
El Chico Restaurants/Tex-Mex restaurants	13¼	-0.18	0.75	17.7	0.66	0.49	2.49	5	90
Summagraphics/scanners, digital tablets and CAD	6¼	-0.07	0.62	10.1	0.40	0.66	0.95	17	77
Sunbelt Nursery/retails lawn & garden products	6⅛	-0.43	0.50	12.3	0.39	0.68	1.96	3	136
Keithley Instruments/electronic test equip	12⅛	-3.43	0.92	13.2	0.55	0.69	2.07	34	95
Golden Poultry/poultry & meat processing	10⅜	-0.04	0.40	25.9	0.46	0.72	1.60	44	353
Sheldahl/electronics	8⅜	0.00	0.53	15.8	0.64	0.74	2.23	73	82
Data General/computer file-servers	11⅜	-2.01	0.33	34.5	0.50	0.81	0.88	37	1,101
Devcon Intl/land development & contracting	8½	-1.41	0.50	17.0	0.72	0.92	0.52	25	77
Gleason/equip for gear manufacturing	15⅜	-0.21	0.75	20.5	0.70	0.95	0.74	24	151
Kulicke & Soffa/semiconductor production equip	8¼	-1.56	0.31	26.6	0.97	0.97	1.68	69	95

[1]Debt plus market value of common, divided by sales. [2] Book value excludes intangible assets such as patents and goodwill.
Sources: Institutional Brokers Estimate System and Value Line via Lotus One Source; Forbes.

How do you make a German cordial with medicinal properties into a bestseller with the college crowd?

Meet the Jägerettes

By Christopher Palmeri

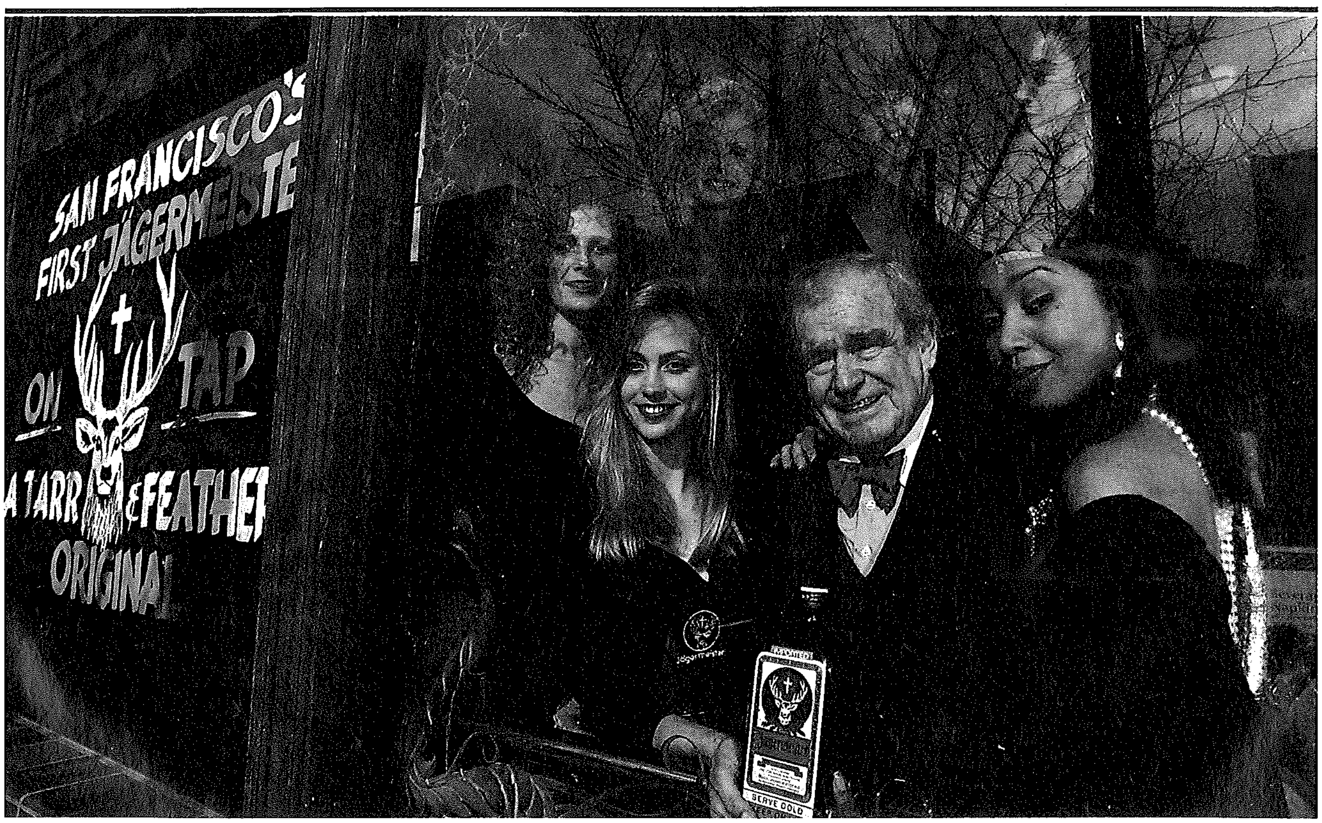
JÄGERMEISTER is a reddish-brown German cordial that tastes like a mixture of root beer, black licorice and Vicks Formula 44. Older Europeans have been sipping it—warm, after dinner—since 1935. Jägermeister's alcoholic content is 35%, but Europeans drink it less for the buzz than for the medicinal value of the drink's 56 herbs and spices.

That sure isn't what sells Jägermeister in the U.S. Witness the scene on a recent Thursday night at Yak-Zies Bar-Grill, a watering hole popular with singles on Chicago's North Side.

Forget about medicinal values. A boisterous crowd is rapidly downing shots of ice-cold Jägermeister, served in test tubes at $2 each. Throughout the bar, six bubbly "Jägerettes"—lithe coeds clad in black bodysuits with plunging necklines—hand out Jägermeister T shirts and cowboy hats. Jägermeister Frisbees fly.

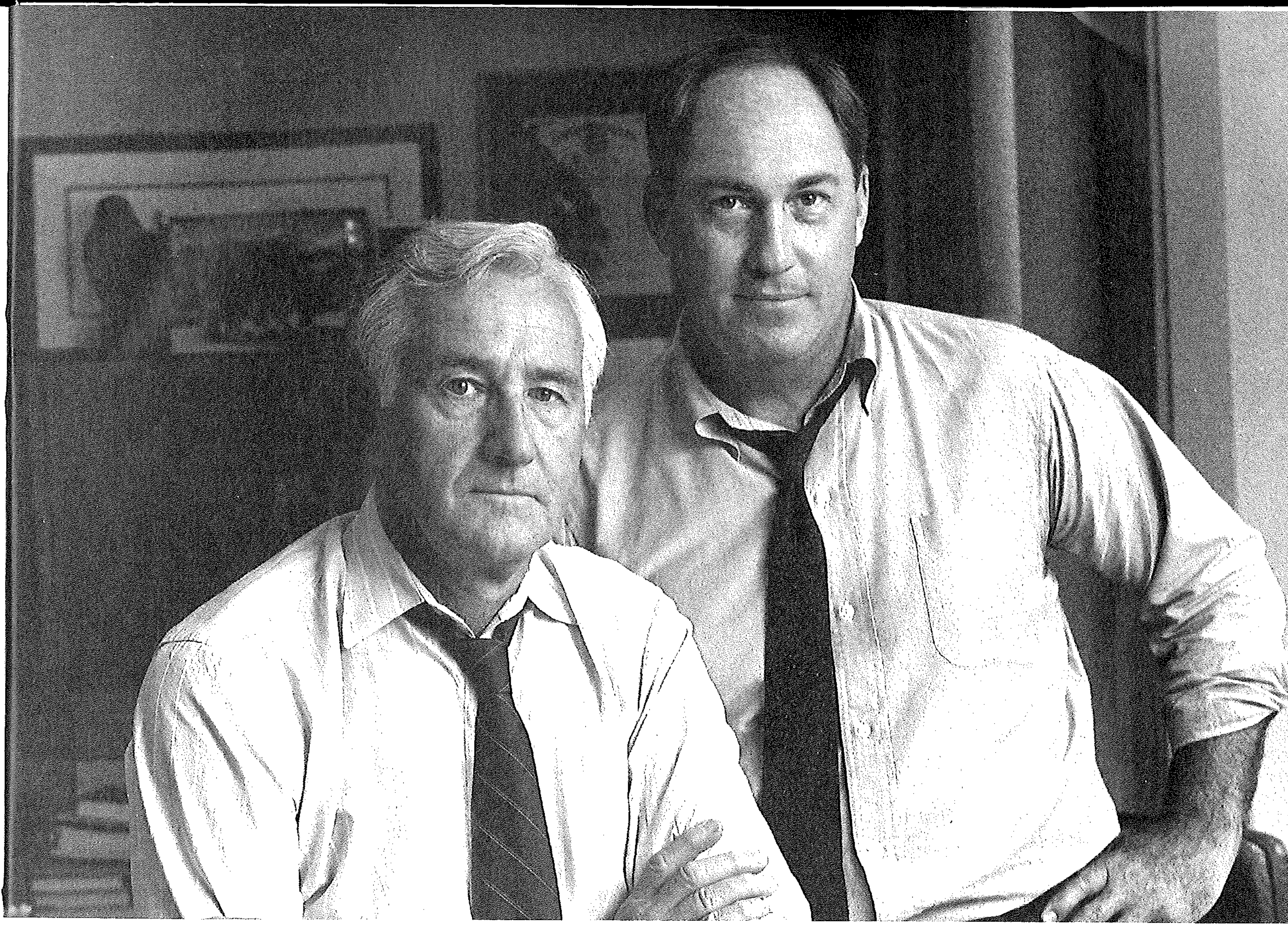
Can all this hoopla really sell cordials? It can and it does. Last year Jägermeister sales jumped more than 30%, to 350,000 cases. From almost nothing in 1980, Jägermeister is now the nation's number four imported cordial, behind Kahlua, Bailey's Irish Cream and Grand Marnier, but ahead of Sambuca Romana and Amaretto di Saronno, according to liquor industry watchers M. Shanken Communications. This year Jägermeister is likely to overtake Grand Marnier. Jägermeister's importer, New Rochelle, N.Y.-based Sidney Frank Importing Co., took in some $42 million last year, 80% of that from distributing Jägermeister.

Sidney Frank, 73, got his first taste of Jägermeister in a bar in New York City in 1974, a few years after leaving Schenley Brands to set up his own liquor importing and distribution company. He visited Jägermeister's distillery in Wolfenbüttel, near Hamburg, and convinced the Mast family, which owns the brand, to give him the distribution rights to the southeastern U.S. But the last thing drinkers in



William Mercer McLeod

Jägermeister's Sidney Frank and the slinky Jägerettes
Sophisticated? No, but who ever said college kids were sophisticated?



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They know that *only* 1-2-3 is fully compatible with 1-2-3.

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Only 1-2-3's 3D technology gives you easy access to 256 worksheets and lets you build 3D formulas just like you do in 2D. Which ultimately makes consolidating, comparing and analyzing data much simpler. In comparison, Excel's Workbook™ is a limited imitation of true 3D. And while working in Group Mode in Borland's® Quattro® Pro for Windows, simply cutting a range of data in one sheet unfortunately means you'll delete the data on every sheet. And what's worse, you can't undo it. All of which means if the analytical power of 3D technology is important to you, 1-2-3 is still the best choice you can make.

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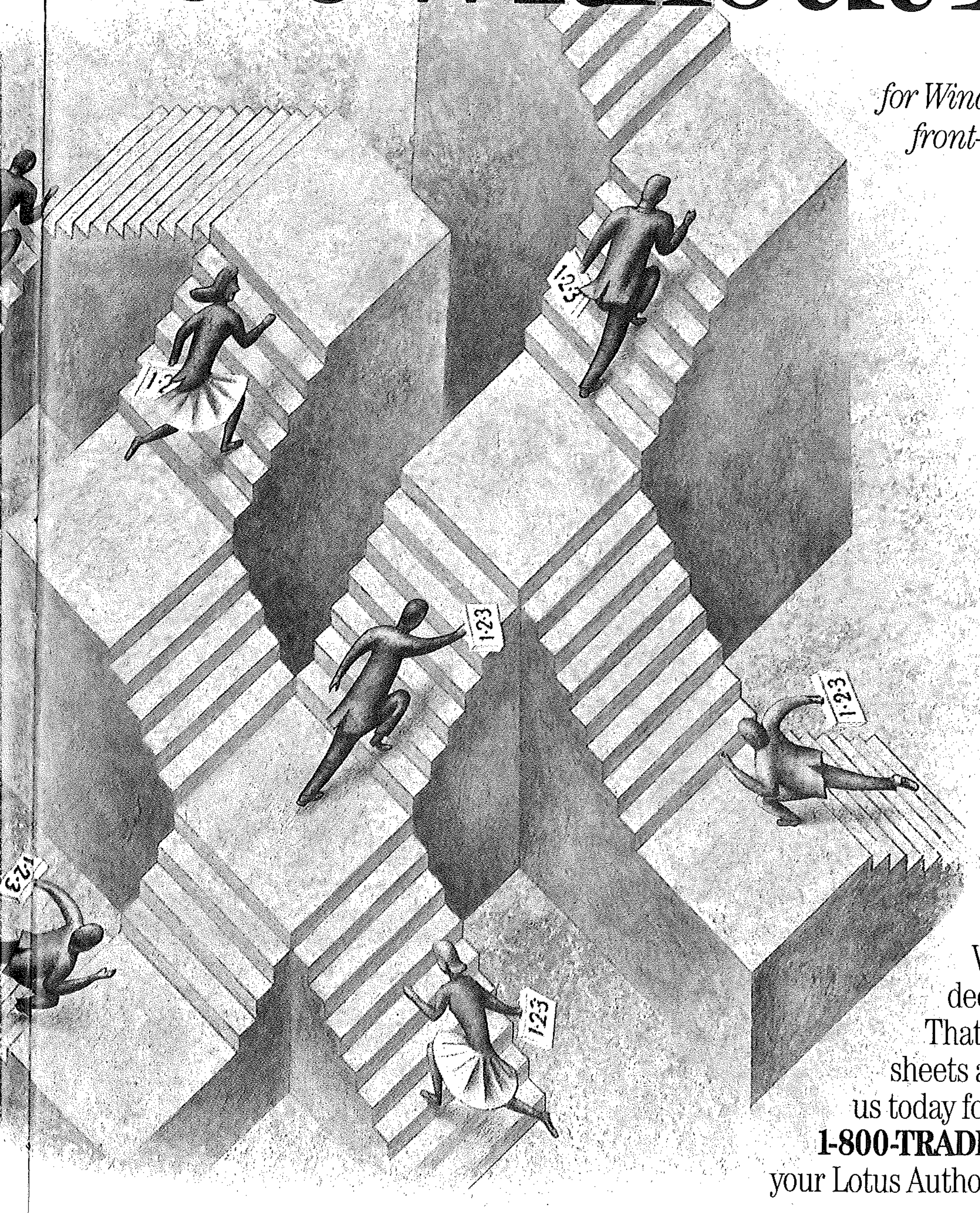

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the sweltering South wanted was a warm Jägermeister. "I didn't know how to sell it," confesses Frank.

Frank's luck changed when he found a bar on New Orleans' Bourbon Street that served up cold Jägermeister shots, poured from a bottle kept in the freezer. Wunderbar! Frank told other New Orleans bars to serve the drink cold, and pretty soon college kids down for the Sugar Bowl were taking bottles of Jägermeister back to school.

By 1985 Frank had acquired the distribution rights for the rest of the U.S. and was ready to come back to New York City. Again he stumbled. An expensive ad campaign featured a series of people making silly faces and proclaiming silly reasons for liking Jägermeister. Says Frank: "People told me they saw the ads, but nobody ever bought the stuff."

So Frank fell back on a well-tested lure for young, restless males: girls.

In 1988 Frank hired his first Jägerette. He outfitted her in sexy clothes and told her to spray shots into people's mouths with a specially configured bottle. The head Jägerette then recruited other young women whom she met in bars. Frank now employs 400 Jägerettes in 25 states, who make $25 an hour for three hours of zany work a night.

The Jägerettes cost Frank more than $1 million a year. Much of the rest of his $6.5 million annual marketing budget goes into promotional trinkets for Jägermeister parties at bars—the Frisbees, T shirts and pennants. A "Jäger Madness" kit contains a button with an arrow that can point to two possible outcomes: "I buy" and "you buy."

Unsophisticated? Yes, but whoever thought college students sophisticated? "The kids love it," gloats Frank. And those sales figures back him up.

This year Frank is expanding his reach into niche markets: rock 'n' roll clubs, black nightclubs, gay bars. For the latter, Frank is now hiring "Jägerdudes."

When asked how long he thinks he can keep up this kind of razzle-dazzle in the treacherous world of fad drinks, Frank turns somewhat defensive. "Everything starts as a fad," he snaps. "Coca-Cola was once a fad." Sidney Frank is thinking big.

Aging baby boomers are dropping out of health clubs and buying lots of exercise equipment to use in the privacy of their homes. So why aren't the equipment makers making much money?

Fancy coatracks

WINTER'S CHILL is in the air, the wassail has worn off, and lists of New Year's resolutions stare grimly back from the refrigerator.

It's time to lose weight and get fit. Which means marketers of stair climbers, exercise bikes, weight machines and similar instruments of self-torture are at the peak of their frenzy to wrest anywhere from $250 to $5,000 from you to counter the ravages of gravity and time.

Sales of home fitness gear always spike in the first quarter of the year, thanks mainly to all those well-meaning New Year's resolutions. Overall, the home fitness market has grown around 10% a year for the past five years, barely pausing for breath during the recession. Sales last year are estimated to have risen 6%, to around $2.2 billion at retail.

The growth has been fueled in part by a growing demographic phenomenon—health club dropouts. These are the people who as taut-limbed 20- and 30-somethings helped pump up the health club craze ten years ago. Today they're older, busier, pudgier and richer. And less interested in socializing and putting their bodies on display at the local health club.

"If you're 40 years old and making $250,000 a year, you don't want to go to a club and sweat next to a 22-year-old kid in a bodysuit," says Jeanne Hopkins, director of sales and marketing for Trotter. Factor in the increased time demands from high-powered jobs and young families, and the perfect customer for Trotter's $3,400-to-$6,000 in-home treadmills emerges.

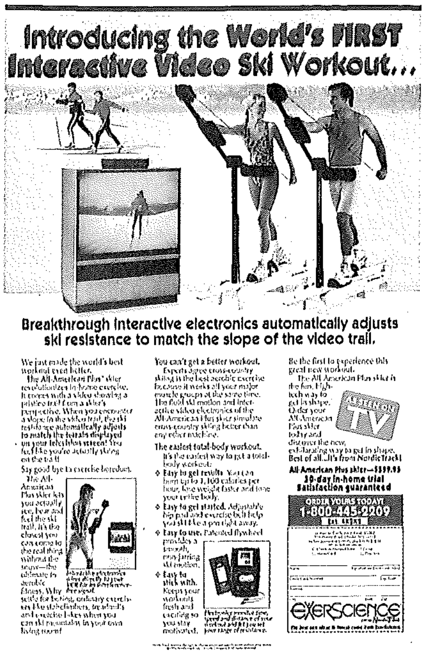
Trotter's ad theme: "For those who consider exercise a matter of privacy." Hopkins says that Trotter's sales grew 24%, to around $25 million, last year.

An ad for Trotter's home treadmills
No sweating next to kids in bodysuits.

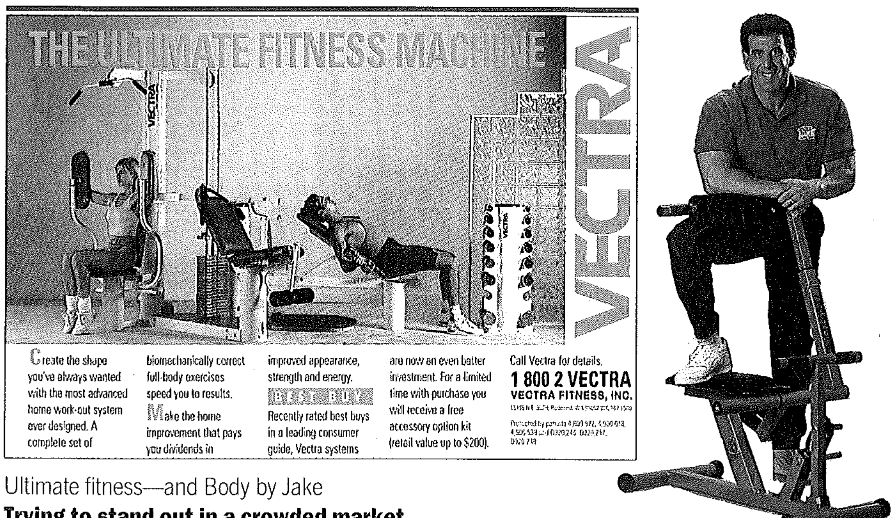
Of the 130 or so makers of home exercise equipment, roughly a third have entered the business within the past two years. One newcomer, San Diego's Aerowind Corp., is beating swords into stair climbers. Aerowind is the largest subcontractor to Hughes Missile Systems for the Tomahawk cruise missile. But 3½ years ago a dimming future for military hardware prompted Aerowind to get into making stair-climbing machines, which can be machined on much of the same equipment used for the Tomahawk.

Aerowind is selling a $1,600 stair-climbing unit for the home, and a $4,000 model for health clubs and hospitals. The big-ticket model includes a built-in television, VCR and videogame.

Unfortunately, the new competition in the home fitness market is



No assembly required, as seen on TV
Home fitness discovers advertising.



Ultimate fitness—and Body by Jake
Trying to stand out in a crowded market.

turning exercise equipment into a commodity business, with few companies making much money. "A lot of people look at the demographics and think there must be a gold mine here, but there isn't," grouses Curtis Nelson, director of sales and marketing for Universal Gym Equipment Inc., which sells weight-lifting machines that retail for between $2,000 and $5,000. Since 1987, Universal's gross margins have slipped from 41% to 37%. Aerowind expects its fitness division to run at a loss for the next couple of years.

To distinguish their products from the pack, the equipment makers are beginning to spend big money on advertising. Diversified Products, Inc., which makes a line of less expensive ($19.95 and up), mass-market exercise machines, is spending $3 million on consumer advertising this year. Last year it spent nothing.

Diversified Products has also formed a partnership with USA Direct—the people who hawk the ubiquitous Juiceman juice-making machine on late-night television infomercials—to sell its new Body by Jake equipment line to consumers directly via an $8.5 million ad effort. The line ties in with Jake Steinfeld, a trainer who parlayed his pectorals into a television career.

But creating brand awareness for muscle-building equipment isn't easy, says William Smith, DP's director of marketing. When DP introduced a Bo Jackson signature line of equipment, it flopped. "It turns out Bo is a better spokesman than he is a brand," says Smith.

Several equipment makers are trying to differentiate their products another way, through sleek design and by loading them up with high-tech gadgetry. For example, Vectra Fitness makes its weight-training machines with elegant, sculpted steel columns. "We can't reinvent the exercise equipment, so we try to reinvent the way it looks," says marketing director Scott Logan.

For its $1,500-a-copy treadmill, Diversified Products looked into licensing the kind of windshield video screen that Hughes Aircraft uses in its jet fighters. However, the added cost would have made the product virtually unsalable.

By all accounts, the exercise equipment company that has most successfully developed a brand name is Chaska, Minn.-based NordicTrack (FORBES, *Mar. 16, 1992*). A division of CML Group, NordicTrack has spent more than $100 million on advertising since 1988 to tout its comparatively austere, unelectrified exercise machines.

Sales for the fiscal year ended last July 31 hit $267 million, up from $37 million in 1988. "We're trying to foster the impression that there's NordicTrack and then there's everybody else," says President Jim Bostic.

But even Bostic seems to feel the exercise equipment market is rapidly maturing. With the estimated $30 million-plus it's spending this year, NordicTrack is extending its brand into food with a line of cookware called Healthy Kitchen. It is also opening fast-food outlets dubbed Healthy Express.

Here's another factor that limits the equipment makers' growth potential. By the spring of every year, many of the machines they sell early in the year are gathering dust or serving as expensive coatracks.

"We sell a lot of stuff to people who never use it," concedes Universal Gym's Nelson. Nelson knows about this. His wife uses his own home gym to hang laundry on. –J.L.

Must the river water New Mexico's Indians use in their ceremonies be made potable? Yes, says the EPA—and the city of Albuquerque shudders.

Riparian extremism

By Nina Munk

IN DECEMBER the Environmental Protection Agency opened another Pandora's box. The agency ruled that under the 1987 Water Quality Act, American Indians living on the Pueblo of Isleta reservation have the right to demand that water taken straight from the Rio Grande as it passes through the pueblo's territory be pure enough to drink.

The city of Albuquerque (pop. 589,131) has since filed suit, claiming that the EPA ruling is both unscientific and arbitrary. Albuquerque, which is about 5 miles upstream from the Isleta reservation (pop. 2,915), would have to pay a horrendous price if forced to comply with the Pueblo's demands.

Trying to make the river water drinkable could cost the city up to $250 million—nearly as much as Albuquerque spends each year operating its city government. Gene Leyendecker, manager of the wastewater utility division in Albuquerque's public works department, estimates that such a river cleanup would raise the average water bill for Albuquerque households from $25 a month to $35. And even after spending all this money, there is no certainty that the water will be pure enough to drink.

The 1987 Water Quality Act was sponsored by then Representative James Howard (D–N.J.). Ronald Reagan vetoed the bill, saying that it was "loaded with waste and larded with pork." It was, but then who could argue against the sacred cause of clean water? Congress easily overrode the veto.

Embodied in the law's fine print is a little-noted provision that gives American Indian tribes the same rights to adopt water-quality standards as a state enjoys. Thus New Mexico can adopt one standard, and the state's Indian reservations can adopt a higher standard if it pleases them to do so.

That's just what the Isleta Pueblo did—abetted by Albuquerque lawyer Lamar Parrish. Then, late last month, the EPA agreed that a second reservation, the Pueblo of Sandia (pop. 3,971), just upstream from Albuquerque *(see map)*, has the right to set its own water standards, too. A third reservation, the Pueblo of San Juan, has also demanded the right, and will probably get it.

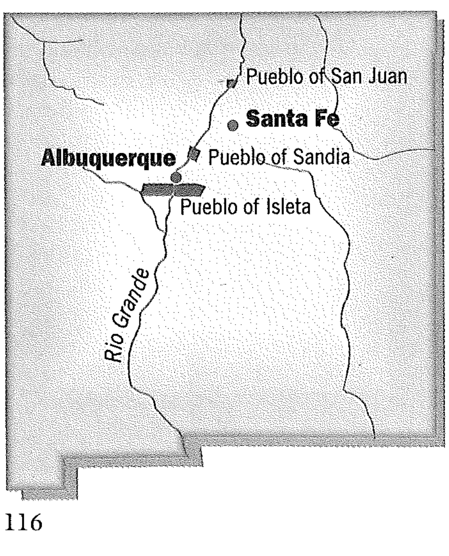
Nobody claims that any of the Pueblos lacks sufficient potable water. But this isn't about needs; it is about "rights." Lamar Parrish, the lawyer who represents all three reservations, claims his clients need potable river water for, among other things, ceremonial use.

"What we're facing is the possibility of having dozens of different water-quality standards in this state," says Ronald Curry, deputy secretary for New Mexico's environment department. "It could be chaos." Says Albuquerque's Gene Leyendecker: "We're all kind of baffled."

Among those especially baffled are business people. Companies that apply for state- and EPA-approved permits to discharge waste could be required to seek Pueblo approval, and be held to ransom for it.

Even the EPA bureaucrats sound worried. "The intent of the Water Quality Act was not to make every waterway drinkable," says EPA spokesman David Bary. "You have to be realistic."

Not if you speak in the name of environmentalism or Indian rights, you don't.



Robert Mansfield/Forbes

Three Pueblo reservations and the river they seek to clean up

Making the river water drinkable could cost Albuquerque up to $250 million.

Buddy Mays/FPG

A few years ago it seemed that Arrow Electronics' Steve Kaufman had no choice but to retrench, but his gut told him to do otherwise.

"I am a growth guy"

By Norm Alster

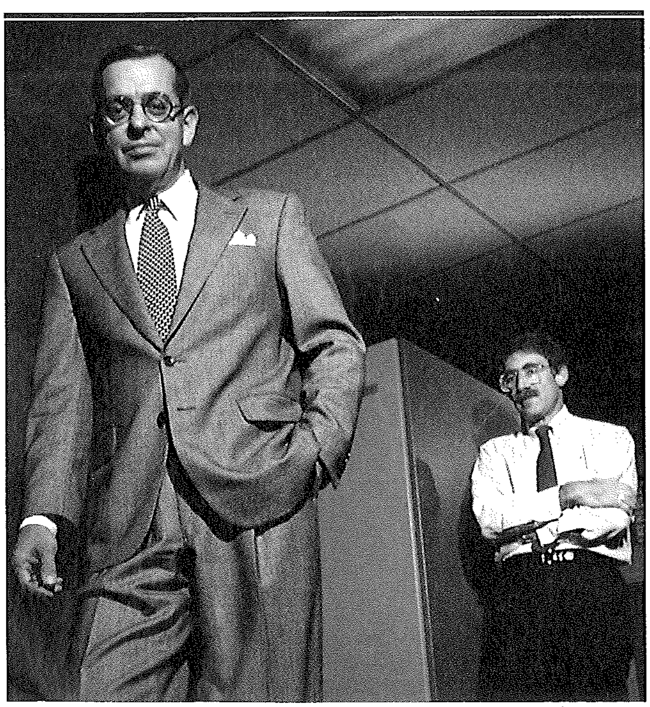
WHEN RUNNING a business it sometimes pays to forge ahead no matter how bad things look. Stephen Kaufman took that risk. Looking back, it was exactly the right thing to do.

Kaufman, 51, is chief executive of Melville, N.Y.-based Arrow Electronics, Inc., the $1.6 billion (estimated 1992 sales) distributor of semiconductors and other computer parts. In 1987 Arrow was in trouble. Still hurting from a tragic hotel fire in 1980 that killed several of its top managers, the company was limping through its third consecutive year of heavy losses. Its debt—much of it at rates as high as 15%—weighed in at twice its equity. "In this industry," says Kaufman, "no one had ever taken on more debt than equity."

Kaufman figured he had two choices. The obvious one: shrink the company, raise cash and pay off debt. Or he could barrel forward by borrowing still more money and making yet another acquisition.

"I am a growth guy by nature," says Kaufman, who decided to take the latter route.

In 1988 Kaufman managed to borrow another $110 million from a group of lenders led by First National Bank of Chicago. He used the money to acquire Kierulff Electronics, a big California-based distributor. As if by a miracle, within a year Arrow's bottom line went from a $16 million operating loss in 1987 to operating profits of $10 million.



Thomas Iannuzzi

Arrow Chairman John Waddell (left) and Chief Executive Stephen Kaufman **To reduce debt they had to first take on more.**

But this was no miracle. It was a straightforward case of economies of scale. Arrow gained Kierulff's customers but was able to shut down all of its four warehouses and move the business into Arrow's warehouses.

In September 1991 Kaufman pulled off a second great acquisition when Arrow gobbled up Lex Electronics, another large distributor. Savings from cuts in personnel, warehousing, information systems and other expenses brought overhead down to just 11% of revenues on incremental postmerger sales, versus 21% before the merger. Lex added around $30 million to Arrow's bottom line.

Seymour Schweber, an industry old-timer whose former company was bought by Arrow in 1991, gives Kaufman a backhanded compliment. "Arrow's profit is made in economies of scale," says Schweber, "which in plain English means firing as many people as you can."

But there's more to Kaufman's success than chopping heads. Arrow stocks some 300,000 different semiconductors and other computer parts and sells them to more than 120,000 customers worldwide. To manage its complex inventory and customer base, Arrow was an early investor in automated warehousing and in centralized on-line computer systems. Without this foresightful investment in information systems and hardware, the Kierulff and Lex acquisitions would have been pointless no matter how many pink slips Kaufman was willing to hand out.

Like most successful people, Kaufman has benefited from luck as well as a good head for business. Starting in mid-1991, low interest rates and a rising equity market set off a chain reaction of good fortune. As Arrow's stock began to rise, Kaufman quickly issued new shares and then used the proceeds to retire Arrow's high coupon debt.

Deleveraging created additional demand for Arrow's securities. Late last year the company sold $125 million in convertible subordinated bonds at a cost of just 5.75%. Debt now comes to 65% of equity—quite a reversal from 1985, when Arrow had $3 in debt for every $1 of equity.

Educated at Massachusetts Institute of Technology and Harvard's business school, Kaufman worked in Europe as a McKinsey consultant during the 1970s. He arrived at Arrow in 1982 a confirmed internationalist. At the time, no other American electronics distributor had invested consistently in the fragmented European market, but Kaufman was convinced that Europe's internal trade barriers would fall and that Arrow could score big in Europe. Beginning with its 1985 purchase of 40% of leading German distributor Spoerle Electronic, Arrow set up shop in leading European markets. By taking large but minority stakes in his biggest European investments, Kaufman has been able to retain the local entrepreneurs who understand their markets better than he could hope to.

Arrow sees tremendous opportunities for improving distribution efficiency in Europe. Today, says Kaufman, it takes three days to ship freight 1,000 miles by truck. And the overnight air freight package that can be shipped for $7 or $8 in the U.S. costs $35 or $40 in Europe. Already Arrow, with $615 million in European sales, is the continent's leading distributor. Arrow's arch U.S. rival, Avnet, was late to expand overseas and is now scurrying to catch up.

Arrow is expected to report earnings of around $45 million for 1992, about $1.55 a share. This year Smith Barney analyst Ann Schwetje thinks it can earn $2.25. But with the company's stock now trading at around 31, up from 3⅝ in early 1991, Schwetje doubts the stock will go much higher in the near future.

The risk Steve Kaufman ran back in 1987 paid off in another way. While he was rolling the dice, conservatively financed Avnet, for decades the leading electronics distributor, eschewed large acquisitions. Now, with worldwide revenues expected to top $2 billion in 1993, Arrow has pulled abreast of Avnet.

"The ship has come in at Arrow," says Chairman John Waddell, who left Wall Street in 1968 to purchase Arrow with two partners, both of whom perished in the 1980 fire. "But some of us have been standing at the dock for 25 years." In Steve Kaufman, Waddell has a good captain. ■

It's tricky to impose financial discipline without stifling managerial initiative. But, as Interpublic shows, it can be done even in a volatile business.

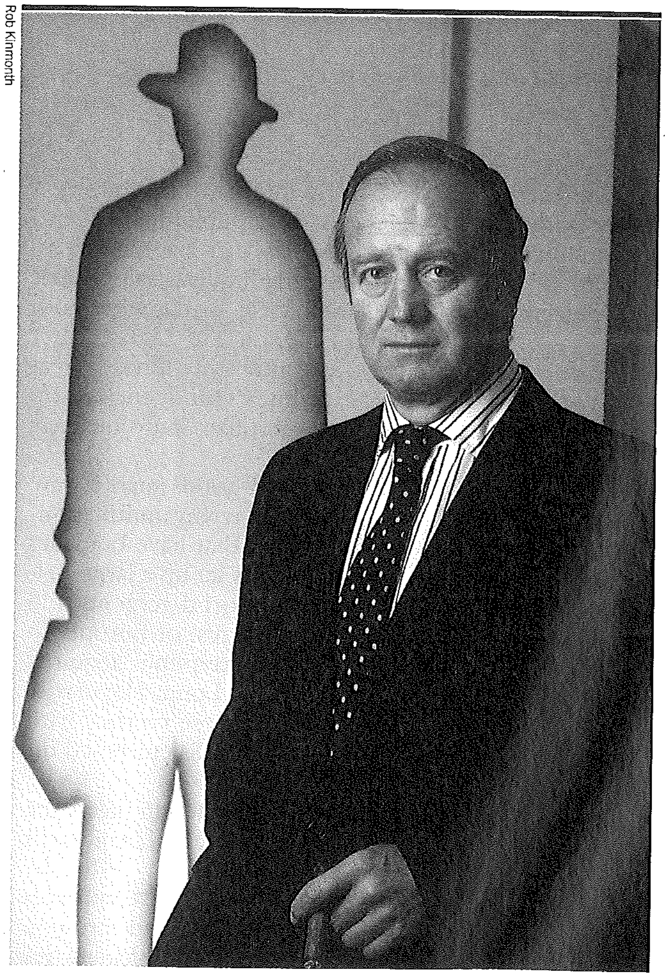
Sibling rivalry

By Gretchen Morgenson

IT'S NOT EASY running an international agglomeration of advertising agencies: WPP Group and Saatchi & Saatchi have gotten into deep trouble with their collections of agencies. That makes the accomplishments of Interpublic Group of Companies Chairman Philip Geier Jr. and Eugene Beard, its chief financial officer, all the more remarkable.

In 11 years under Geier and Beard, Interpublic's revenues have more than tripled, to an estimated $1.9 billion last year; return on equity has averaged 18%. Interpublic's stock has climbed over fifteenfold since 1982, to a recent 34⅜, 24 times trailing earnings.

Saatchi & Saatchi, hobbled by years of financial turmoil and client defections, lost $218 million in 1991; its stock recently traded at 7⅝, down from a high of 22½ in 1991. WPP Group is in even worse shape: Its stock recently traded at less than 2, down from a 1990 price of 24. The company lost $51 million on revenues of $2.25 billion in 1991.



Rob Kinmonth

Philip Geier Jr., Interpublic's chairman
Don't just sell advertising ideas, sell the idea of advertising.

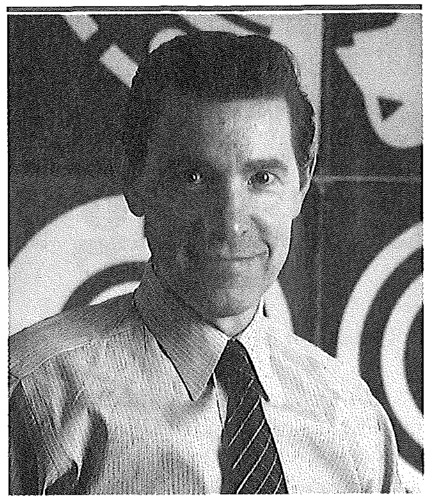
The secret to Interpublic's relative success is simple enough. Simple to describe, but hard to execute. It involves a combination of tight financial controls at the parent with creative autonomy at each of the four agencies that make up Interpublic. Essentially, the parent watches the numbers and lets the agencies do what they will so long as they attain the desired numbers. Interpublic owns: New York-based McCann-Erickson, a 65-year-old but still strong outfit; New York-based Lintas: Worldwide; California-based Dailey & Associates; the U.K.'s Lowe Group.

Each of the four competes with its siblings for accounts. Combined, they serve 4,000 clients in 91 countries.

While each agency has its own style, all must toe the line financially. "While [Interpublic's] new business has tripled in the past ten years, corporate budgets have stayed flat in the last five years," Chief Financial Officer Beard says. You have to stay lean to survive in this business. After a decade of healthy annual growth in the 1980s, the advertising industry went into a slump in 1990, and is picking up only meagerly. Worldwide ad spending, nearly $300 billion last year, is likely to rise only 4.7% in 1993, says James Dougherty, an analyst at Dean Witter Reynolds. And the clients are getting chintzier with the agencies. This year Interpublic will book about 14% of billings as revenues; that's down a full percentage point from a decade ago.

Executives at Interpublic's agencies are acutely aware today that besides selling advertising ideas, they must increasingly sell the idea of advertising itself in a era of corporate cutbacks and competition from other forms of product promotion. They whip out case studies: A 12.4% decline in ad spending on 12 consumer goods products in the mid- to late 1980s resulted in a 20% drop in market share; when a marketer of salad dressing reduced ad spending by 27%, its product's share fell 45%. Indeed, after several years of reduced ad expenditures, Geier says: "Companies now realize how brand franchises have been affected. The ones that didn't cut advertising are better off than those that did."

Geier's pitch seems to be working:



Rob Kinmonth

Eugene Beard, chief financial officer
Have the right incentives.

In 1991, a year in which spending declined in seven of the top ten U.S. advertising categories, Interpublic won a record $800 million in net new billings. Last year it won an estimated $825 million, a little more than half from existing clients. While overall food company advertising declined 10% in the first half of 1992, Geier reports that his firm's larger packaged goods clients, such as Coca-Cola, Unilever and Nestlé, upped their spending to 9% in 1992.

As a truly international collection of agencies, Interpublic has a lot to offer companies that are seeking to expand geographically. Swiss-based food giant Nestlé works with both McCann-Erickson and Lintas. Peter Brabeck, executive vice president at Nestlé, explains, "Our agencies help us to cross-fertilize our business internationally."

Some branded-goods markets are very local—which is why multinationals need agencies that have branches everywhere. Lintas set up a large Belgian office to support detergents sold by Unilever in the rest of Europe. In North Carolina, Interpublic acquired the local agency of Long, Haymes & Carr to maintain close contact with Hanes, the Winston-Salem-based division of Sara Lee.

How does headquarters keep the creative types in line? Management incentives established in 1984 by Geier and Beard make sure employees focus on profitability and growth. Five different formulas calculate rewards for employees.

The compensation is based on long-term performance—or at least long-term as understood in the world of advertising: four years' performance but awarded every two years. This helps keep managers from jumping ship, an ever-present agency business threat. Employees are rewarded with stock and bonuses, not only for making their numbers but also for qualitative results, such as setting up succession plans and servicing clients. "We're very big on trying to keep people," says Geier. He has been helped by a rising stock price; employees own 17% of Interpublic's outstanding shares.

There's a healthy amount of rivalry here. The incentive formulas reward a Lintas account executive for winning a new client in competition over McCann, or vice versa. For example, last year McCann won the $30 million Goodyear account in a race that included Lintas.

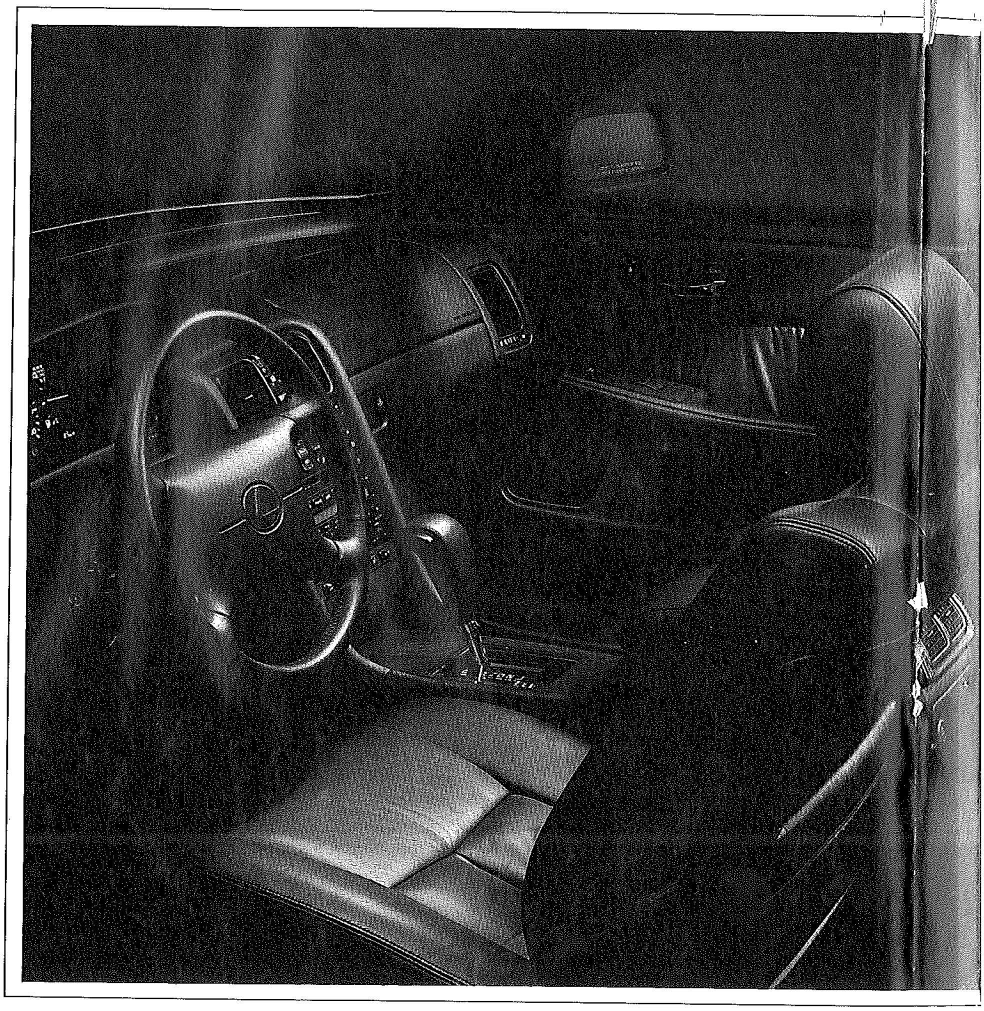
Tight-fisted Beard runs Interpublic's in-house acquisition team; at no time during the past decade have investment bankers been invited to advise Interpublic on any of its more than 100 purchases. Wisely, Beard wants to make his decisions without prodding from Wall Street types anxious to close deals.

Keeping his head while WPP and Saatchi lost theirs, Beard never paid more than eight times cash flow for a company and avoided altogether sales promotion firms, public relations agencies and training companies. Says Beard: "I could never justify 20 or 30 times earnings for an investment hung to one person who would run out the door as soon as the deal was done."

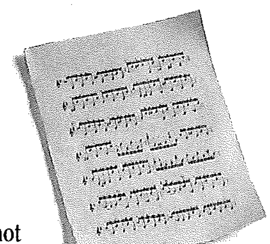
Interpublic made only acquisitions that would place it in new markets or strengthen existing client relationships. Examples: the 1991 purchase of Brazil's MPM Group, to enhance Lintas' Unilever business, and Ronnberg & Co. in Sweden, to help cement McCann-Erickson's new relationship with McDonald's.

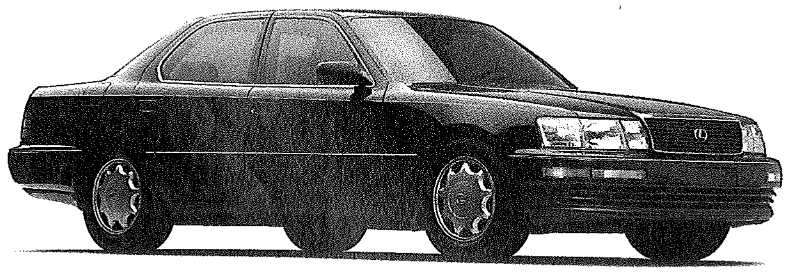
It's tricky in any business to balance the need for creative independence in a far-flung enterprise with the need for accountability and controls. Interpublic shows that it can be done even in a particularly volatile business.

A Cabin? Or A Rec

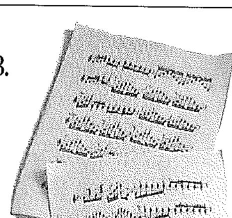


One day last December, the classical guitarist Manuel Barrueco performed and recorded a suite by the 19th-century Spanish composer Isaac Albéniz for later broadcast on radio stations across the country. By itself, this fact is not unusual. What *is* unusual is that his performance wasn't recorded in a sound studio. It was recorded in the cabin of the 1993 Lexus LS 400. *At 55 mph.*





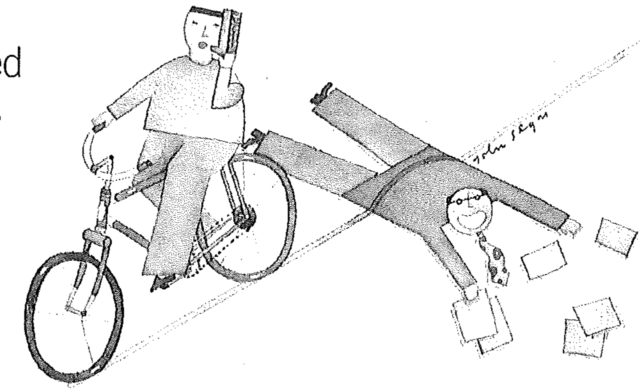
Outside: the rustling of leaves caused by the speed generated from the 32-valve, 250-hp V8.



Inside: the sweet and pure notes from Mr. Barrueco's handmade, cedar-topped guitar.

Here's a story stock P.T. Barnum would have liked when he said there's a sucker born every minute.

China calling



By Richard L. Stern and Amy Feldman

GET ON THE PHONE quick, pigeon, and call your broker: Here's a small, over-the-counter company with rights to operate cellular phone service in markets that embrace 300 million people, including the mighty cities of Shanghai and Beijing. If every one of those Chinese makes just one cellular telephone call per day. . . .

What's the company's name? MTC Electronic Technologies Co., and it's headquartered near Vancouver, home to a wild and woolly stock exchange.

Last October a Japanese firm in New York, Daiwa Securities America Inc., filed a preliminary prospectus to sell 1.2 million new MTC shares to the public on top of the 8.2 million already outstanding. Daiwa later increased the size of the offering to 5 million shares. Although the offering has not yet been made, announcement of it sent MTC's shares rising from 8¾ to 27⅝ in December.

FORBES hopes you weren't one of the buyers. MTC has "exclusive rights" to nothing. "It is not possible for a foreign corporation to own or operate a telephone system [in China]," says Beijing-based Zhao Yong, a spokeswoman for the Ministry of Posts & Telecommunications.

In Shanghai, Zhao Xing Shang of the Shanghai Post & Telecommunication Administration explained that a foreign company could get approval to do financing of telecommunications or set up a factory to produce cellular equipment and telephones, but not to operate the system itself. These officials should know. Their agencies are the ones that would have to approve such joint ventures.

In its preliminary prospectus MTC says it will sell thousands of cellular phones in China at $1,000 apiece. Yet brand-name suppliers, including Motorola, LM Ericsson, NEC and Oki, have already sold some 100,000 cellular telephones in metropolitan areas throughout China. Motorola wholesales its phones to Chinese government entities for about $500, and the government resells them to the public for more than $2,000. In any case, MTC says its cellular phones would come from NEC parts.

MTC's president and chairman is Miko Leung, a 49-year-old, chain-smoking, Hong Kong-born entrepreneur. Leung has a habit of promising more than he can deliver.

In 1987 MTC announced an exclusive distribution deal to import 1.2 million televisions into the U.S. and Canada from China for $161 million. Total MTC sales from 1987 to 1989: a mere $64 million. MTC lost about $400,000 in the same period. Having risen when the TV story was released to 6½ a share, from 5½, MTC's shares slid back to just 2⅝ in October 1987.

Most of MTC's actual business has involved selling fax machines into China while exporting low-priced TVs and other consumer electronics from China to North America.

In 1991, to get away from the Vancouver Stock Exchange's unsavory reputation, Leung moved MTC Electronic to trading over-the-counter on the Nasdaq market. It hasn't improved the way the company—or its friends—do business. During a recent road show for the stock in Chicago, with an MTC executive present, a Daiwa analyst was overly optimistic. He projected earnings of $9 per share by 1996, largely based on profits from fees from cellular subscribers in China.

A marketmaker of MTC, Pennsylvania Merchant Group Ltd., projected last October that for fiscal 1994 some 60% of operating profits, or $11 million, would come from cellular handsets on MTC Electronic's own systems in China.

Chairman Leung was not available for FORBES, and Daiwa spokesman Stanley Ginsberg says he can't comment on MTC. But Daiwa seems concerned about what has been going on at MTC. It has now issued three revisions to the original prospectus, the latest on Jan. 19. Gone are claims about exclusive agreements, and what had been presented as final contracts are now only maybe contracts.

The latest prospectus even admits that MTC will be paid by barter, in the form of consumer goods it will export to North America.

In an earlier prospectus MTC claimed it already was operating a test system for 1,000 users in Shanghai. Neither Chinese government officials FORBES spoke to nor executives for other foreign telecommunications companies in China know where that test system for 1,000 users is situated.

Here's one thing for sure. MTC Electronic has leased some equipment to the Shanghai city government for expansion of its cellular system built by Sweden's Ericsson. Motorola built and supplied the other half of this European-style cellular system.

But if the Chinese aren't buying MTC's China story, foreign investors apparently are. MTC's stock was still trading recently at nearly 20. At that price the company has a market capitalization of $200 million. Revenues: $43 million. Profits: $2 million, or 47 cents a share.

Short traders, such as Gilford Securities in Chicago, smell a killing. The short position recently was about 257,000 shares. Daiwa apparently intends to proceed with its offering. It looks as if some sheep are about to be shorn. ■

Companies accused of wrongdoing often investigate themselves. But are such probes convincing—even from the most respectable of lawyers?

Who pays the piper . . .

By Dana Wechsler Linden and Neil Weinberg

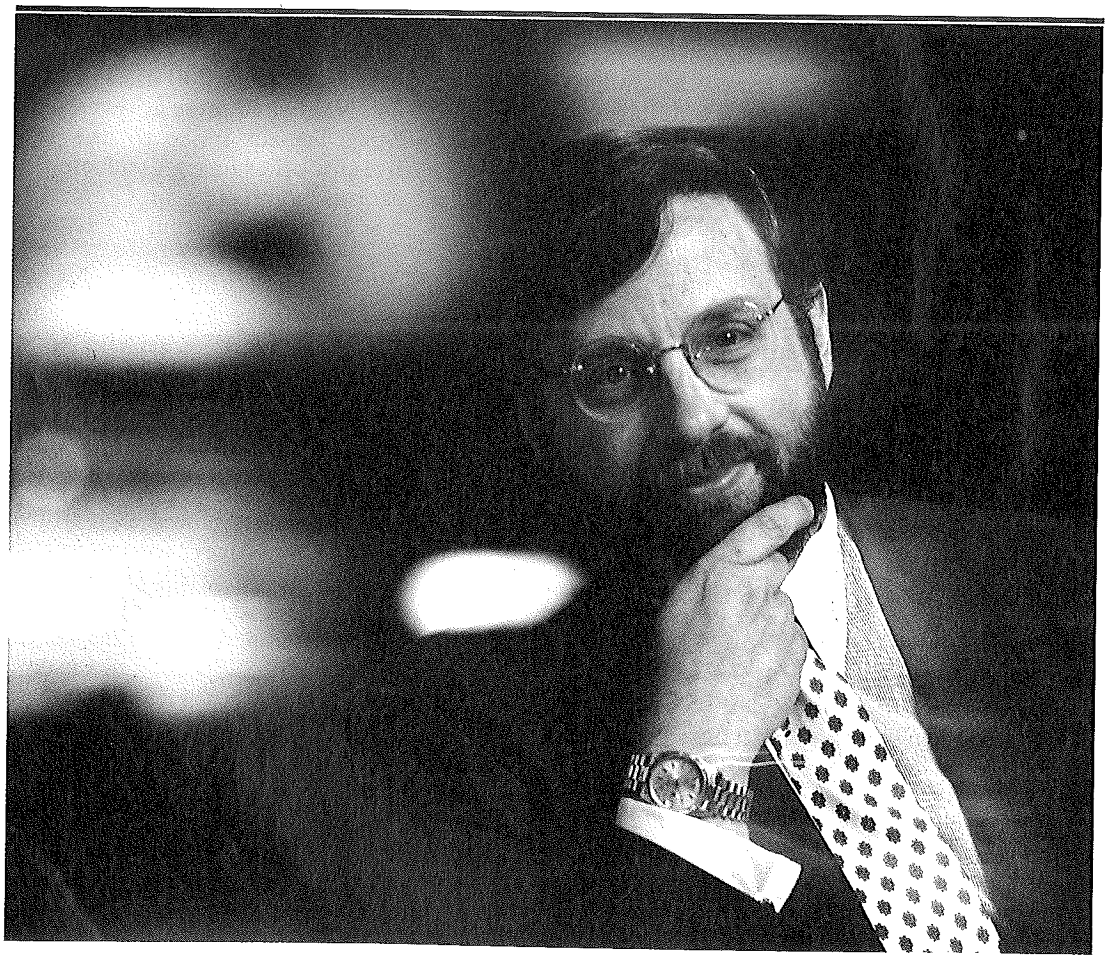
WHEN FACED WITH possible wrongdoing these days, many companies quickly call in a prominent lawyer as special counsel. The attorney investigates, then reports to a special committee of the board. If the report is favorable to management it can serve as a stamp of approval to ward off shareholder suits—and often shore up a flagging stock. Among the major companies that have conducted such probes in the last few years are Salomon Brothers, General Electric and Dow Corning.

But the practice remains controversial. No matter how much integrity the lawyers have, outsiders remain aware that the lawyers are investigating their own clients. As the old saying goes: "Who pays the piper calls the tune." This is not literally true in these cases, because no reputable lawyer would deliberately cover up wrongdoing. The suspicion remains, however, that at the very least the investigator is favorably inclined toward the investigated.

Paul Wright, a former Securities & Exchange Commission staffer who is a member of the American Bar Association committee on law and accounting, points out: "You can call in the best lawyer in the world and restrict the scope of the investigation so you know he's not going to find anything." Especially when the lawyers doing the actual investigating are typically young associates recently out of law school who don't know that much about business.

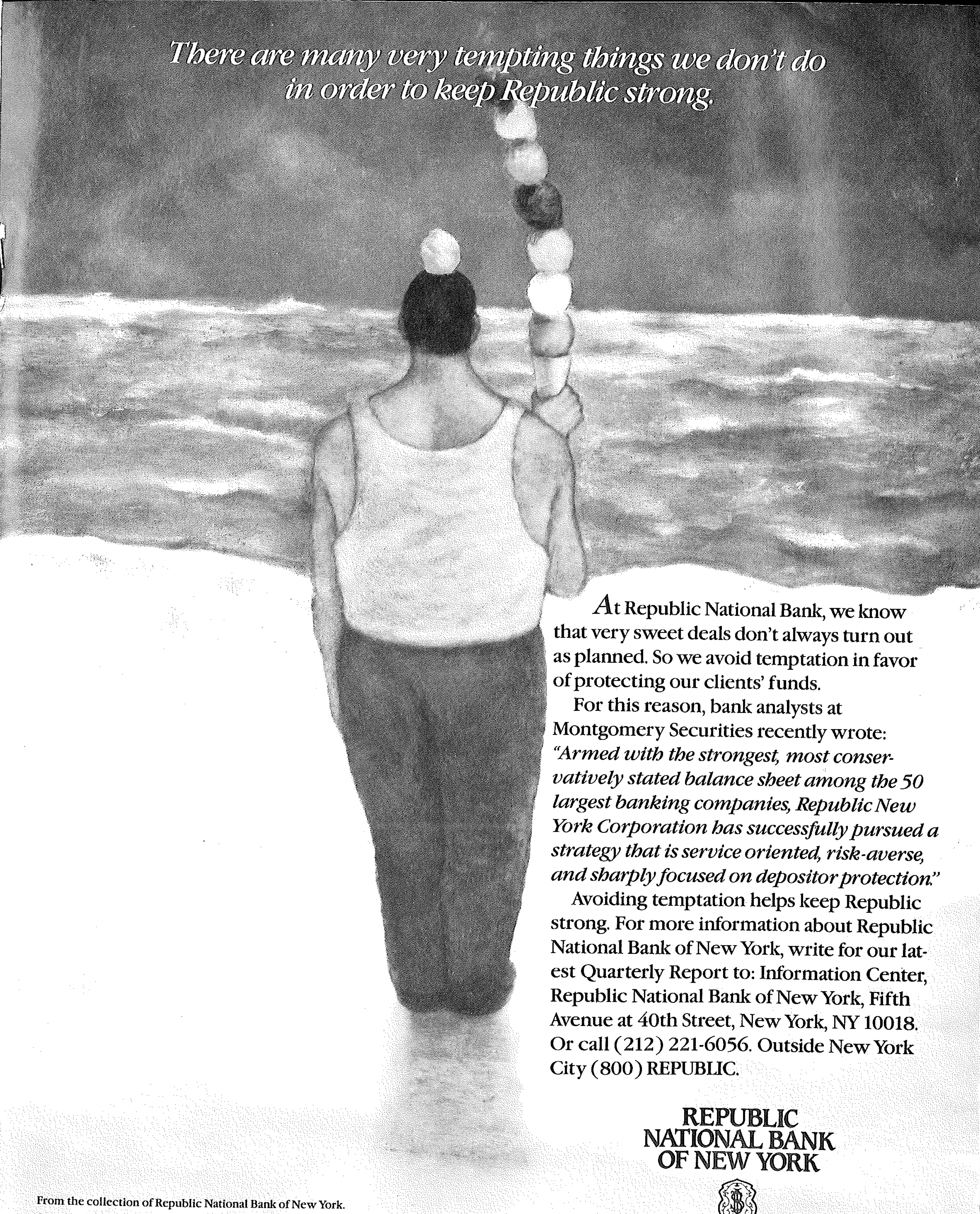
"There's always been doubt about whether these [investigations] are whitewash operations," says Charles Wolfram, a legal ethics professor at Cornell. "If there's also the hope of future business, it puts a light to the outside that it is indeed a whitewash."

At a time when parts of the legal profession are facing tough times, billings in these investigations run



Susan Steinkamp/SABA

SEC former general counsel Harvey Pitt
A self-described Boy Scout who's called in to investigate corporate right from wrong. Yet his work raises troublesome questions of its own.


There are many very tempting things we don't do
in order to keep Republic strong.

from tens of thousands to several million dollars. Some of the best and most reputable lawyers in the country are playing the game. Washington lawyers like former U.S. Attorney General Griffin Bell of King & Spalding and former Securities & Exchange Commission lawyer Arthur Mathews of Wilmer, Cutler & Pickering take in a steady stream of special investigative work these days.

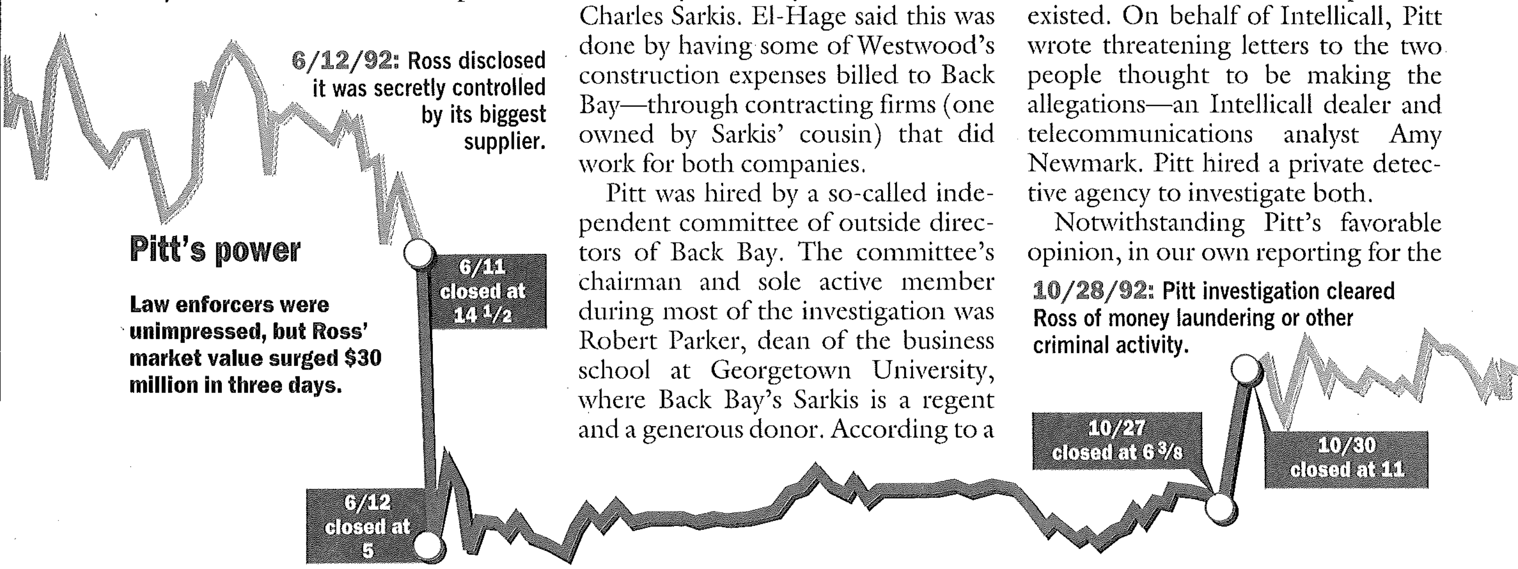
New York's Wachtell, Lipton, Rosen & Katz conducted Salomon's recent internal investigation of its Treasury auction scandal. The report resulted in the suspension of two top officials.

"This [practice] has become a critical and integral part of corporate governance," says Harvey Pitt, former SEC general counsel and a partner at Fried, Frank, Harris, Shriver & Jacobson.

Pitt, at 47, is probably at the top of everyone's list of such corporate governors. One of the nation's most prominent securities lawyers, he was the chief defense counsel for Ivan Boesky and got his client a light sentence for flagrantly criminal conduct.

The brilliant Pitt is nearly a match for a Lexis terminal when it comes to spouting out past cases and precedents. He is, by any standard, one of the nation's outstanding attorneys. No shrinking violet, Pitt likes to describe himself as a Boy Scout. Certainly he has never been accused of any wrongdoing.

But several recent investigatory cases handled by Pitt suggest that this method of paying for your own investigation may be flawed.



Take one of Pitt's clients, Back Bay Restaurants, a publicly traded, Boston-based chain of family-style restaurants. Last October Back Bay's board brought in Fried, Frank to investigate concerns raised by the company's chief financial officer, Nabil El-Hage, who has since resigned.

Newspaper reports said El-Hage made serious charges: that Back Bay schemed to shore up ailing Westwood Group, a racetrack operator largely owned by Back Bay Chief Executive Charles Sarkis. El-Hage said this was done by having some of Westwood's construction expenses billed to Back Bay—through contracting firms (one owned by Sarkis' cousin) that did work for both companies.

Pitt was hired by a so-called independent committee of outside directors of Back Bay. The committee's chairman and sole active member during most of the investigation was Robert Parker, dean of the business school at Georgetown University, where Back Bay's Sarkis is a regent and a generous donor. According to a FORBES source, Sarkis has pledged half a million dollars over the next five years to Georgetown. (Neither Sarkis nor Georgetown will confirm or deny the amount of the pledge.)

After a few weeks of investigation, much done by young Fried, Frank associates, Back Bay issued a press release announcing that the special committee "uncovered no facts that would materially impact the financial statements of the company."

How arms-length was the investigation? Instead of bringing in an outside auditor, Pitt relied on Coopers & Lybrand, which had signed off on Westwood's previous financial statements and was also the outside auditor for Back Bay. This special investigation was not Fried, Frank's first assignment for Back Bay. In March of last year the firm did legal work for Back Bay's initial public offering.

Pitt tells FORBES: "I've worked very, very hard to develop a reputation, and I value it so much that I don't want to do anything that would compromise the integrity of my approach."

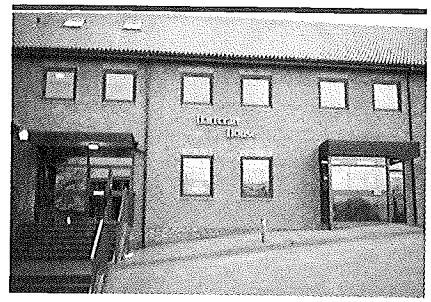
But the case of Intellicall (FORBES, *Nov. 25, 1991*) certainly did nothing to enhance Pitt's mystique. The maker of pay telephones hired him in March 1991 to look into allegations that management was committing accounting fraud, shipping out products that no customer had agreed to pay for yet—and booking the shipments as sales.

Pitt's conclusion: No such problem existed. On behalf of Intellicall, Pitt wrote threatening letters to the two people thought to be making the allegations—an Intellicall dealer and telecommunications analyst Amy Newmark. Pitt hired a private detective agency to investigate both.

Notwithstanding Pitt's favorable opinion, in our own reporting for the Intellicall story FORBES uncovered facts disturbingly consistent with the allegations. And less than a year after Pitt cleared the company's name, four senior officials were dismissed for a different infraction. The company was found to have misrepresented its debt on financial statements, and to have hidden from shareholders and the banks the fact that it was in violation of its loan covenants. Intellicall's stock dropped 30%. Was Pitt embarrassed that the same company he cleared of cooking the books in one way later misrepresented its financial statements in another way?

Reminding FORBES that he cannot discuss Intellicall specifically, Pitt growls: "I have never been embarrassed by anything I have done in any special investigation."

The Intellicall audit cost the company about $80,000. The firm then hired Fried, Frank again for another $1.1 million worth of corporate work



Why is this company so secretive?

The official address for S&J Perfume, U.K. supplier of Ross' fragrances, is an empty storefront (left). Its outside auditors work upstairs. A former company address (above) is a private home. S&J does have a suite in an office building near London (right). FORBES called there and asked where S&J's factory is. A man said nervously, "We don't want to reveal that sort of information, it's all part of a plan."

over the next nine months.

Pitt may have taken on his most difficult assignment yet when he launched an investigation into Duncan, S.C.-based $47 million (fiscal 1992 sales) Ross Cosmetics Distribution Centers, which reported a 66% increase in profits in the fiscal year ended last Aug. 31. Ross' main business: selling cheap knockoffs of designer perfumes. "Our alternative to Giorgio," reads the label on Ross' fragrance called Gorgeous, which sells for about $5, compared with $50 for Giorgio.

Ross Cosmetics' Nasdaq-traded shares have plunged over 50% from a high of 28 last March. In response to swirling rumors, the company disclosed last June that it was secretly controlled by the owners of English perfume manufacturer S&J Perfume Co. Ltd., Ross's leading supplier.

What's wrong with that? The two Indian families (both have the surname Sheth) who own S&J had accumulated 63% of Ross' stock through an elaborate labyrinth of Panamanian corporations, some of which owned 4.3% of the company, just below federal disclosure requirements.

The disclosure of the Sheths' control set traders, short-sellers and government enforcers to speculating about possible money laundering, drug smuggling and stock price manipulation. Ross appointed an independent committee of the board. Pitt got the call.

After a four-month, $1.6 million probe, the committee announced in October that it had found "no basis" for these rumors. The Sheths were merely unwitting victims of unscrupulous financial advisers—who failed to tell them about U.S. disclosure requirements.

Despite this, Ross' name has not been cleared. The SEC is continuing its investigation of the company. The U.S. Customs Service is preparing a criminal investigation. "These people have absolutely illogical ways of moving product around the world, and there has to be a reason for it," says a fraud expert at U.S. Customs.

FORBES has learned that 18 months ago British law enforcement officials raided two of the Sheth perfume factories. They had "very, very good information that massive quantities" of counterfeit perfume were being produced, says an investigator involved in the raid. The Sheths were supposedly putting their own fragrances in Chanel packages and selling them for 10 or 20 times the price of their own perfumes.

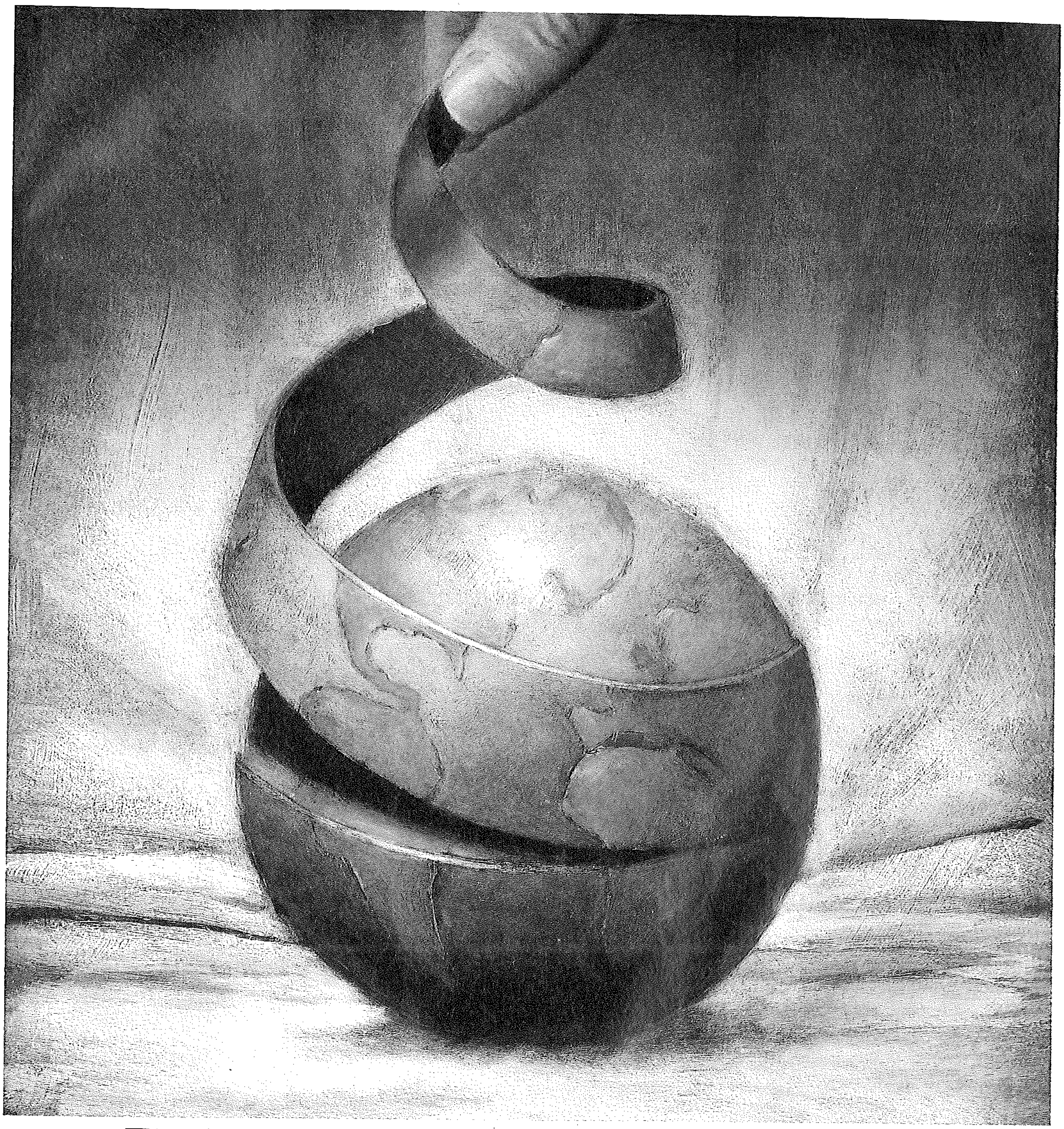
The raid turned up no evidence of counterfeiting. Yet British officials tell FORBES they believe their information was correct. They believe the counterfeit operation has been moved, and that the counterfeit boxes are still being produced at a printing factory in Nottingham. That factory is owned by one of the Sheths' Panamanian corporations, of which Eugene Derry—the main financial adviser who was criticized by Pitt and the special committee for misleading the Sheths—is an officer.

Derry, an upper-class Englishman who lives in Switzerland, controls 102 Panamanian corporations himself, and is said to have been involved in deals with Peter Francis Crosby, a financial scamster now in jail in Geneva. A follow-up raid in Nottingham is being planned.

Did Pitt's investigation uncover evidence of these additional wrongs? We put the question to Pitt, who responded: "There are things that are put in [special committee] reports and things that aren't, and those are always questions of judgment, and I can't respond specifically."

Why would a lawyer of Harvey Pitt's standing and seven-figure annual income get involved with a business as questionable as Ross Cosmetics? He scarcely needs the money, but Pitt is something of a curmudgeon and no great admirer of prosecutors. He answers our question in ideological terms: "Let me tell you: I do it if I can be of help to a public company. I really believe in the process by which public companies govern themselves effectively."

FORBES would agree with that. But in the cases of Ross Cosmetics, Intellicall and Back Bay, it is by no means certain that—Pitt's investigations notwithstanding—these companies have been governing themselves effectively. Rightly or wrongly, such self-investigations are coming under a cloud.



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Are your legal bills too high? Here's the newest way to control lawyer fees.

Piecework

By David Frum

REVIEWING A legal bill can be a frustrating experience. How can a client know whether the work in fact took the time the law firm says it did, or was even necessary? In a paper presented at last summer's American Bar Association meeting, Zoë Baird, then Aetna's general counsel and President Clinton's failed choice for Attorney General, noted that nearly two-thirds of all clients felt that their lawyers were too cavalier about costs.

It's easy to see how the clients got that idea. Since 1977, according to Robert Litan of the Brookings Institution and Steven Salop of Georgetown University, the revenues of the legal services industry have compounded at 12% a year, faster even than those of the health care industry. By 1989, the last year cited by Litan and Salop, the cost to society of the law industry's revenues had exceeded \$75 billion, or roughly one-fourth the total profits of all U.S. corporations that year.

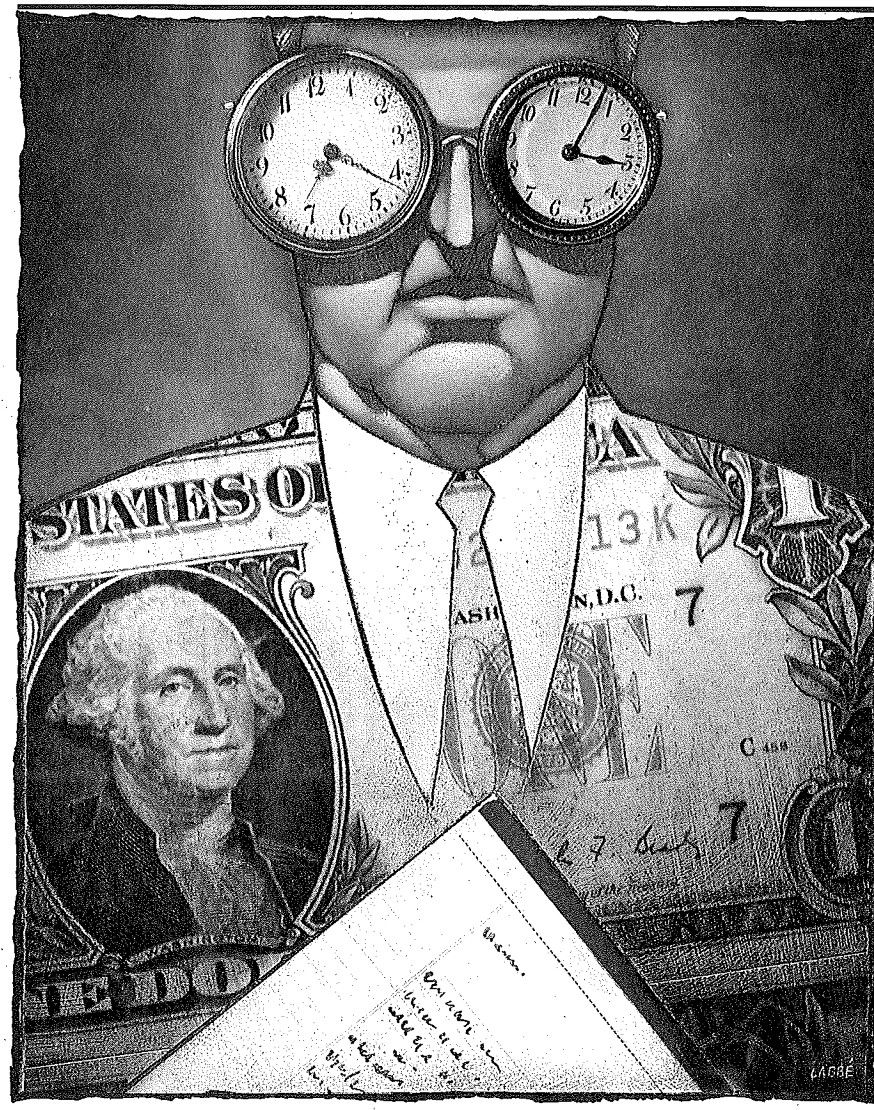
Legal cost inflation began at about the same time that hourly billing became common. As recently as the 1960s it was unusual for lawyers to keep time records. Hourly fees began to spread in the late 1960s and early 1970s because they seemed to promise more precise and objective legal bills than annual retainers or fees for service.

Instead, billing by the hour institutionalized a conflict of interest between lawyer and client. The more time the lawyer put in, the richer he got, whether the time was well spent or not. As Zoë Baird put it to the American Bar Association: "Hourly billing pushes economic incentives in the wrong direction—weakening rather than strengthening the bonds between performance and pay."

In a major study published in the *Rutgers Law Review* in 1991, Cumberland School of Law Professor William Ross reported that of 272 attorneys he surveyed, 60% admitted to knowledge of bill padding.

Is there a better way to pay lawyers? Bickel & Brewer, a 43-attorney Dallas-based law partnership that specializes in complex corporate litigation, thinks there is. Seventy percent of Bickel & Brewer's new business is signed on an individually negotiated flat-fee basis. And if the firm gets a better result for its client than had been originally anticipated, it also gets an individually negotiated performance bonus.

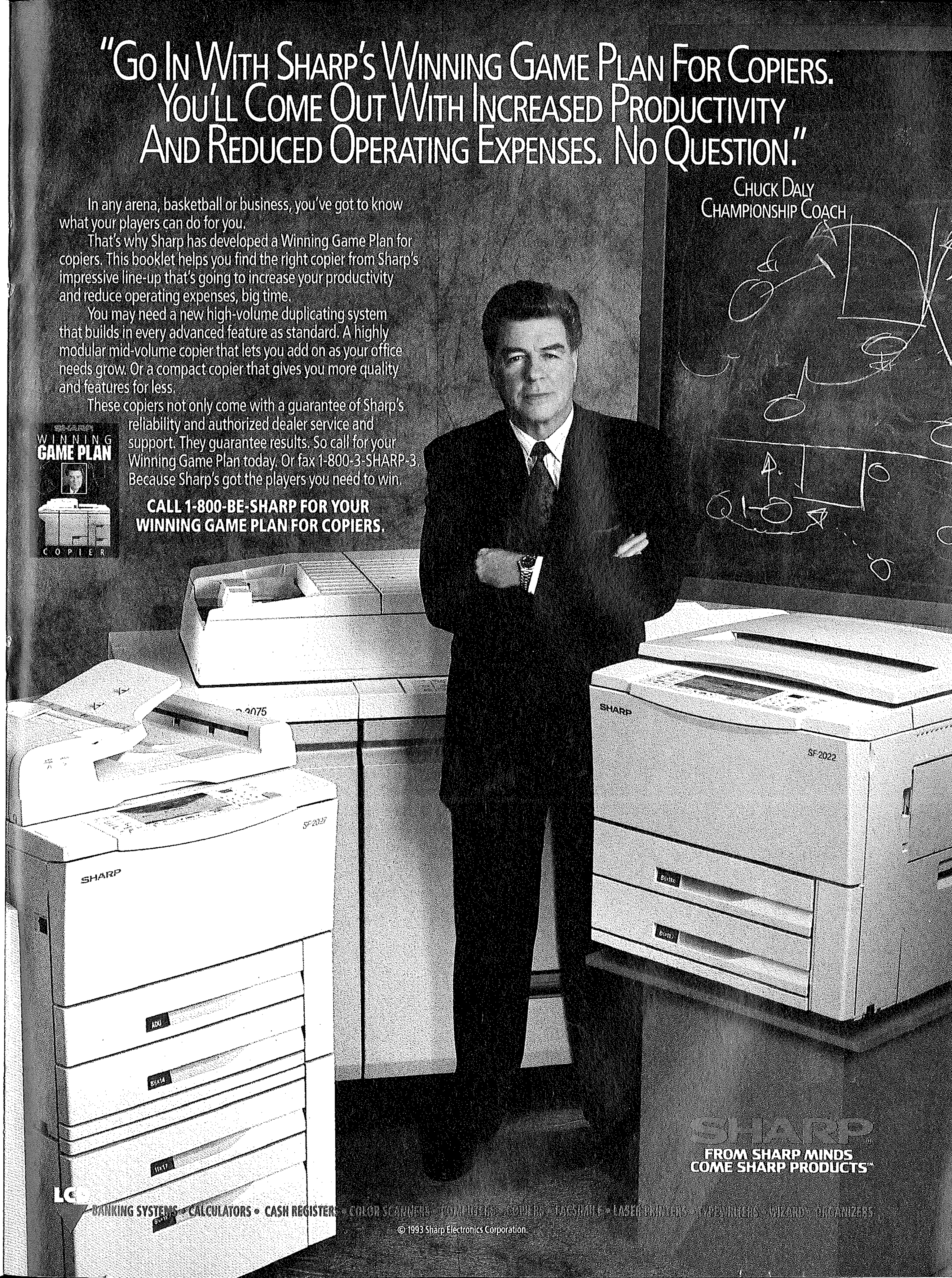
Michael Grove, general counsel for Bellcore (the old Bell Labs), in Livingston, N.J., and a Bickel & Brewer client, is delighted to see the end of



John Labbé

hourly billing. A flat fee, Grove says, "enables me to budget more exactly." And performance bonuses "create an incentive for the law firm to do well."

Hourly fees, on the other hand, create incentives for lawyers to skimp on productivity-improving technology. "It is jarring," writes Cumber-



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brakes,
en supercharged.”
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PONTIAC
WE ARE DRIVING EXCITEMENT

land's Ross in his 1991 article, "to walk through the corridors of a typical large firm and see attorneys sitting in their offices scrawling out briefs, letters and discovery requests in longhand on yellow legal pads like Victorian clerks."

Worse, Ross adds, hourly billing tempts lawyers to do unnecessary work, to duplicate work—and even to lie. Ross reported that 20% of the lawyers he surveyed even believed that it is ethical to bill a client for research or other work originally done for another client and recycled.

Abuses like these have brought a whole new industry into being: the legal bill checker. John Marquess, a lawyer himself, is chairman of Legalgard, a Philadelphia company that scrutinizes legal bills for clients like Liberty Mutual Insurance, Mattel and the state of New Jersey. Business, says Marquess, is hopping. Legalgard's revenues have tripled (to $3.6 million last year) in each of the five years since its founding.

Marquess says reviewing about 2 million legal bills has convinced him that inefficiency and bill padding are rampant. "The problems we see in Tuscaloosa, Ala. are the same as the problems we see in Boston," he says.

Marquess doesn't agree, however, that Bickel & Brewer's flat fee offers a solution. Because legal costs—especially on the defense side—are inherently hard to predict, any flat fee, Marquess argues, "must allow for a giant margin." Nor does he favor the performance bonus concept: "As a lawyer, I'm being hired to do a great job. I don't deserve a bonus for doing what I was hired to do." Better, in Marquess' opinion, that clients should scrutinize their legal bills, or hire a firm like Legalgard to do it for them.

Still, if the new flat fee billing techniques are imperfect, they at least eliminate some of the inherent conflict of interest between attorney and client. Bickel & Brewer's managing partner, William Brewer, makes a good point when he says: "Any businessman will tell you that a system of compensation is irrational if it pays without regard to result. A lawyer's work ought to be valued according to its contribution to the bottom line." ■

IRS huffing over independent contractors has companies and workers running. There are defenses.

How the bar girls beat the IRS

By Richard Phalon

WHAT IS THE common thread among these taxpayers: exotic dancers in Dallas, carpet installers in New Jersey and a professor of finance at the University of Michigan's business school? They were all accused by federal or state tax auditors of masquerading as self-employed independent contractors when they should have been classified as employees.

These cases are part of a highly publicized dragnet that involves, so the Internal Revenue Service alleges, $20 billion a year in unpaid and underreported taxes. When workers claim to be self-employed, they're on their own for remitting income and Social Security taxes. Since a lot of them underreport their income or are broke when taxes are due, contends the Service, the government is out a lot of revenue.

T.Campion/Sygma

Bar hostess and friend
A win for the working girl.

The taxman's solution to this problem is to go after companies that use these workers. If the tax authorities can prove that a worker is an employee, not a self-employed independent, they can dun the employer for all the taxes that should have been withheld, plus penalties (FORBES, *Mar. 2, 1992*).

So when is a worker an independent? The definitions in the tax law are so ambiguous and the potential penalties for misclassifying a worker so high that many big companies are running for cover. They are forcing formerly independent workers onto the payrolls of outside firms, such as Career Blazers, a temporary help company, or Payroll Options Unlimited, a division of Uniforce Services. Thus drug manufacturer Pfizer and magazine publisher Condé Nast recently farmed out a number of researchers, copy editors and the like to third-party payrolls.

There's a net loss to the players when a worker goes on a payroll. A worker on a payroll is much more limited in tax writeoffs that can be taken (for retirement savings or job-related expenses) than an independent. Two further costs to the ultimate employer: the inevitable passthrough of Social Security and unemployment taxes and the third-party payroll firm's margin of profit.

So don't cave in too readily to the tax collector's anti-contractor campaign, says James Urquhart III, an Irvine, Calif. attorney who specializes in tax and other issues involving independent contractors. The running box score in Urquhart's newsletter, *The Independent Contractor Report,* suggests that state and federal auditors lose as many cases as they win. Among the losses: cases involving the dancers, the carpet installers and the business school professor. All were held to be independent contractors.

Some Urquhart tips that will help buttress independents:

■ Have multiple clients. Advertise in the Yellow Pages. In the Carpet Remnant Warehouse case, decided by the New Jersey Supreme Court in June 1991, the installers seemed to carry all the earmarks of independents. They could choose among jobs the compa-

ny posted on a bulletin board, worked for other companies, controlled their hours, got paid by the yard rather than by the hour, negotiated directly with customers on the cost of extras and were at risk. They stood to lose if they had to repair defective work.

Incorporating your business may help. The New Jersey Department of Labor, which unsuccessfully chased the carpeters through the courts, never even went after the one installer doing business as a corporation.

■ If your accountant for some reason thinks incorporating is not a good idea, reinforce your sphere of independence by filing with the IRS for an employer identification number. You'll need a form SS-4. Also consider working under a business name.

■ Work under a written agreement that, among other things, specifies it can be terminated without cause by either party on 30 days' notice. The point here is that employees often can't be fired at will. Independent contractors can.

■ Bill by the assignment on an invoice you've had printed on your own. Business cards identifying you as independent rather than a company representative are another useful piece of stationery to have on hand.

■ Accept no medical, pension or other fringe benefits. Pay your own Social Security, Medicare and income tax installments directly. University of Michigan Professor James Reece beat the feds partly because it was clear he received no fringes for outside seminars designed and conducted for a center founded by the university.

■ Realize that many of the "common law" tests the federal and state auditors use boil down to questions of control. Freedom to come and go, to work at your own speed, with your own methods and no supervision are all very much to the point. It also helps to own or rent office space away from home.

Look at the Dallas exotic dancers. They worked on the saloon premises all right, but were definitely not employees of the joint. In fact, they paid $20 to $40 a night for the right to work there. Their compensation came not from the barkeep but in the form of tips from the customers. In all, another small triumph of enterprise over the revenuers. ■

Out of a young Australian's thwarted ambitions has risen a global company that is already fourth in the beer business. Meet Foster's Brewing Group.

Soap opera Down Under

By Subrata N. Chakravarty

THE PLOT doesn't resemble Oliver Stone's saga of Gordon Gekko. It's much closer to an old Abbott and Costello slapstick job. But it does seem to have a happy ending.

Act One: An Australian Harold Geneen, John Elliott, 51, his head full of ideas picked up in business school, takes an obscure food company, makes hundreds of acquisitions and builds Elders IXL Ltd. (now Foster's Brewing Group Ltd.) into Australia's largest conglomerate, with revenues of around $14 billion in fiscal 1989, which ends in June. Unlike Harold Geneen, whose career seemingly inspired his, Elliott builds his company on a mountain of debt—some $5.5 billion worth, almost double the shareholders' equity of roughly $3 billion.

Act Two: An irate board ousts Elliott as chief executive and appoints a subordinate, Peter Bartels. The new man, the tough, no-nonsense head of the conglomerate's beer operations, holds a fire sale of nonbrewing assets and suspends the dividend in order to reduce debt.

Act Three: Elliott, who remains the largest stockholder through a heavily leveraged personal holding company, mounts a proxy fight to win back control or at least force Bartels to resume the dividend. The Foster's stock is the company's principal asset, and the dividend Elliott's only way of servicing the debt. In a compromise, the Foster's board of directors agrees to the creation of a stockholders' watchdog committee operating in parallel with the board, but excluding Chief Executive Bartels.

Act Four: An outraged Bartels quits. His successor, an able career brewer, insists that he be a member of the stockholder committee before he'll take the job. The stockholder committee never meets again.

Act Five: In June 1992 Broken Hill Proprietary Co., Ltd., Australia's giant steel, mining and energy company, comes onstage. Broken Hill owns some $750 million in preferred stock in Elliott's holding company. To try salvaging its investment, Broken Hill buys the holding company's 37% stake in Foster's by paying off the banks that held it as collateral for the company's loans.

Act Six: Philip Morris Cos.' Miller Brewing unit buys 20% of Foster's Canadian joint venture with Molson Cos. Ltd. Japan's Asahi Breweries, Ltd. is already a minority sharehold-

Former Foster's chief executives John Elliott (left) and Peter Bartels
One created Australia's largest conglomerate. The other had to slim it down.

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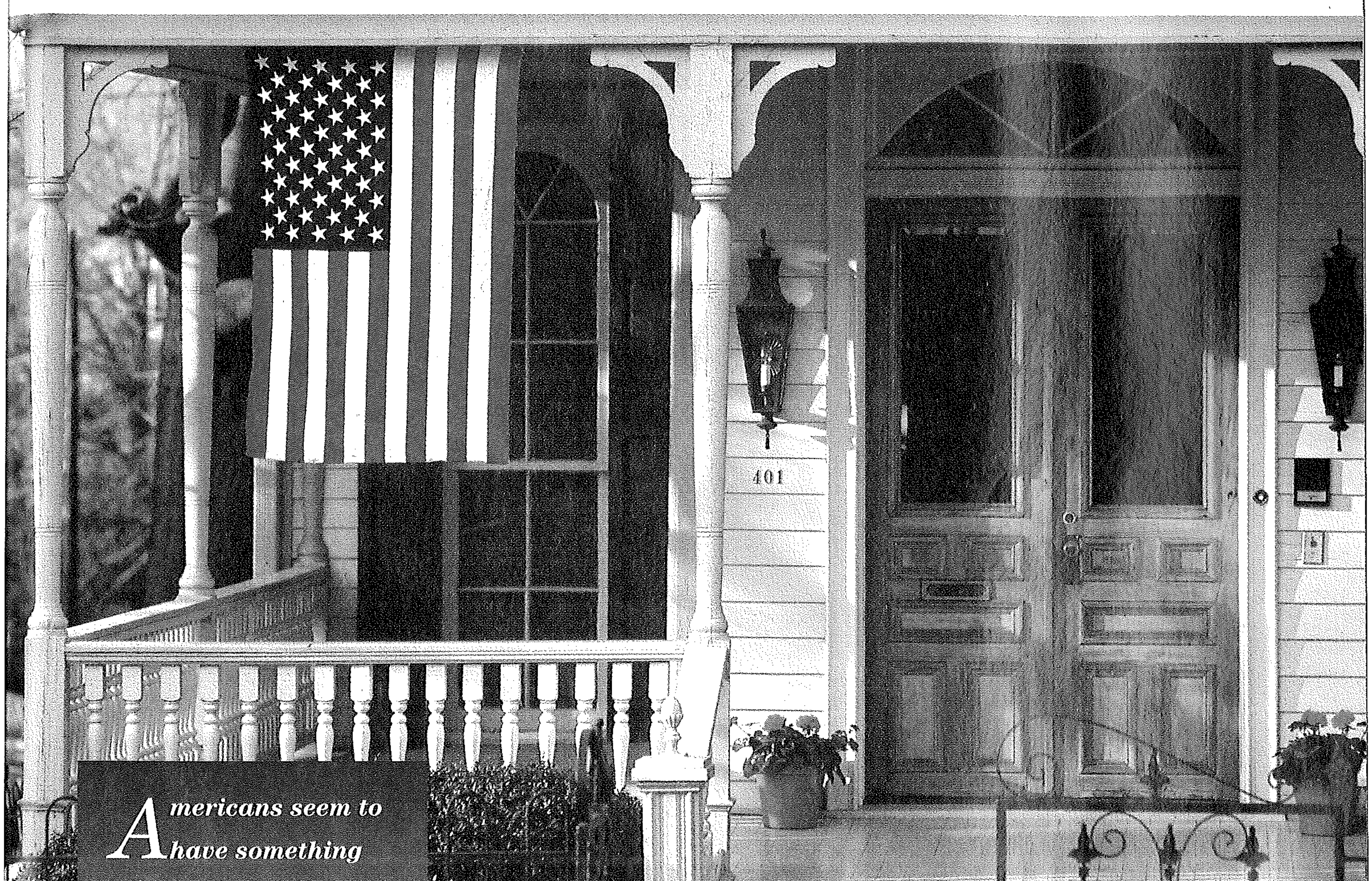

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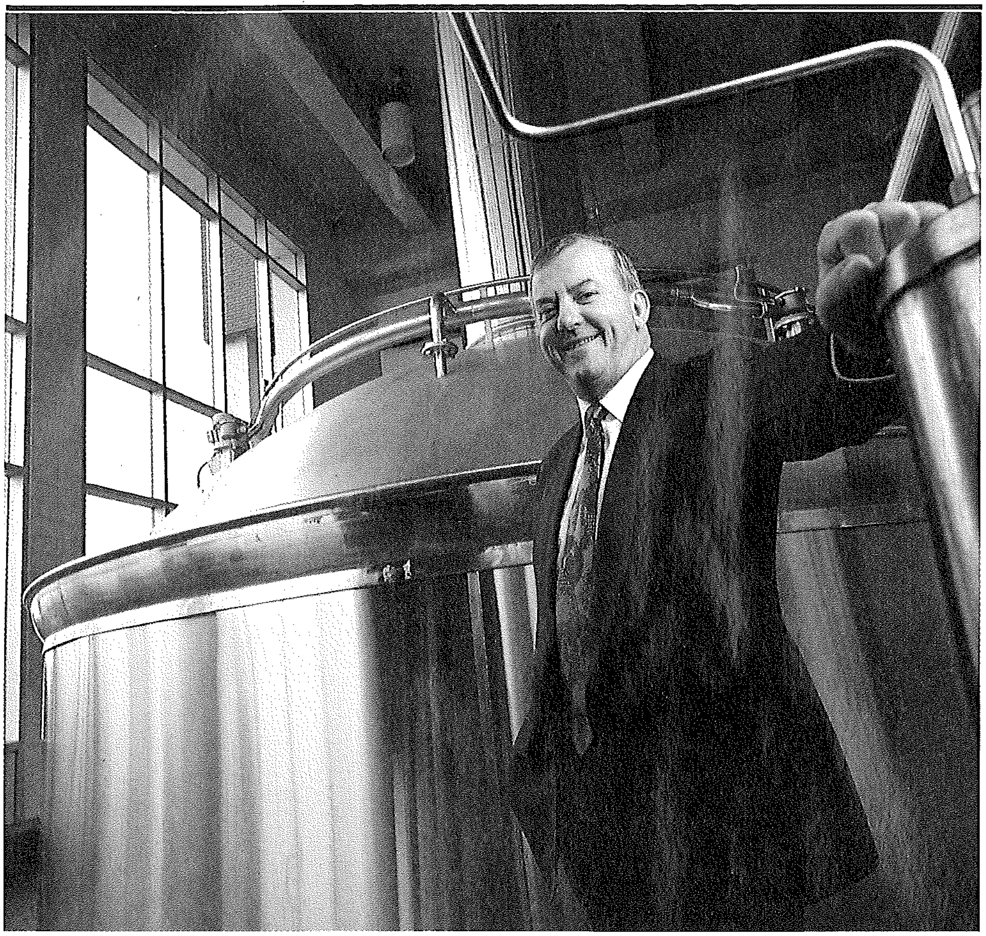


Rob Waymen

Edward T. Kunkel, Foster's Brewing Group's chief executive, at a brewery
Breweries exist to create cash flow, not just to make beer.

er in Foster's.

Who's in charge around here? Nobody seemed to know. Not only did the ship seem to lack a captain, it appeared to have lost its entire steering apparatus. Nevertheless, the vessel itself is otherwise shipshape. Foster's, whose brews are available in the U.S. market, is the fourth-largest brewer in the world and has the world's only multinational brewing operation.

This was a farce that might have ended as tragedy but finally has a happy ending—and a strong captain at the helm.

He's Edward T. (Ted) Kunkel, the head of Molson Breweries, Foster's partnership with the Molson Cos. With Broken Hill firmly behind him, Kunkel, a 49-year-old New Zealander, wrote down the approximately $2.1 billion in nonbrewing assets that were still on the books to some $1.3 billion. Other overvalued properties were also written down. In all, Kunkel took nearly $1 billion in charges in fiscal 1992.

"We want this company to be judged on its brewing units going forward," Kunkel says. "You have to appropriately provision the nonbrewing assets so that you don't believe they're going to impact the P&L in the future."

To shore up Foster's finances, Kunkel raised some $700 million in new equity this fall with a special rights issue. Stockholders would get the right to buy two shares for every five owned, at about 75 cents per share. By exercising its rights, Broken Hill raised its stake in Foster's further, to almost $2 billion, for shares with a current market value of roughly $1.2 billion. Asahi exercised only half its rights and saw its ownership drop from 20% to 16% of the company. Philip Morris has no direct stake in the Australian parent.

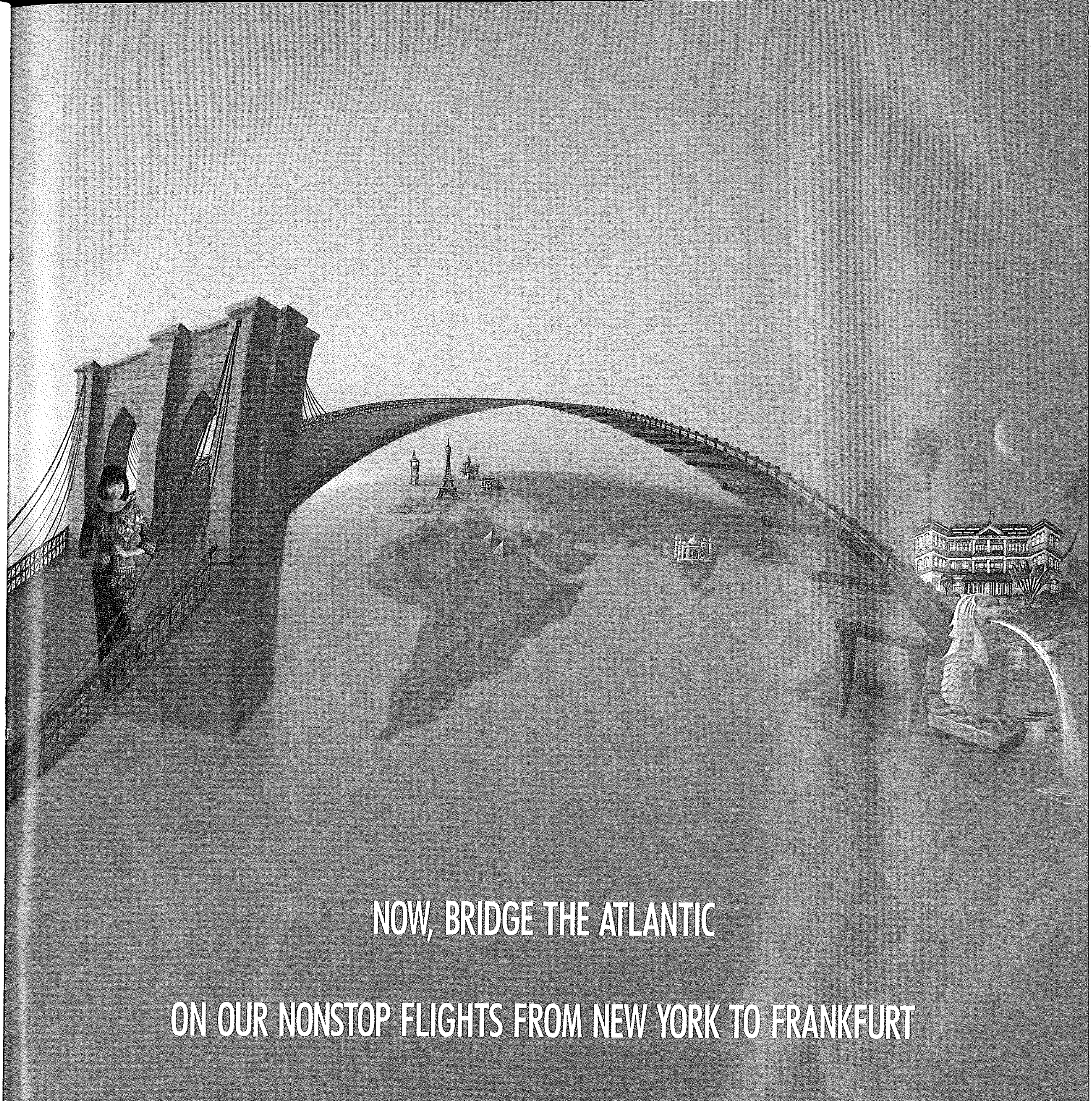
The comic-opera turmoil largely behind him and the slate wiped clean of past mistakes, Ted Kunkel is set to make Foster's a bigger player on the world stage. A brewer to the core, with 25 years in the business, he helped turn Foster's Brewing Group from an obscure regional brewer in the Australian state of Victoria into a multinational brewer, which has the largest market share in Australia and Canada and the second largest in the U.K. It is also the second-largest importer into the U.S., where it has big plans for its partnership with Molson Cos. and Miller Brewing.

As recently as 1980 the Foster's brand was just another name among dozens in a nation known for its parochial, regional beer-drinking tastes. How to turn Foster's into a national brand? Bruce Siney, now Foster's group marketing director, came up with an ingenious scheme. He would establish Foster's overseas and bring it back to the rest of Australia as an international brand.

The boomerang ploy worked beautifully. "Foster's was taken offshore and brought back in a cachet sense," recalls Kunkel. "Australians still had parochial brand preferences, but the moment an Australian became an international traveler, he adopted the Australian brand which he found abroad." By the mid-1980s Foster's had become the dominant brand nationwide.

The marketing strategy also made an international star out of Paul Hogan, with his "It's Australian for beer, mate" commercials. And there was an unexpected dividend: Foreign sales, begun as a marketing ploy for the home market, proved to be a highly profitable vehicle for further growth.

In 1986, with some of the money borrowed by the ambitious John Elliott, Foster's bought Britain's Courage Breweries. In 1987 Foster's entered the Canadian market by acquir-



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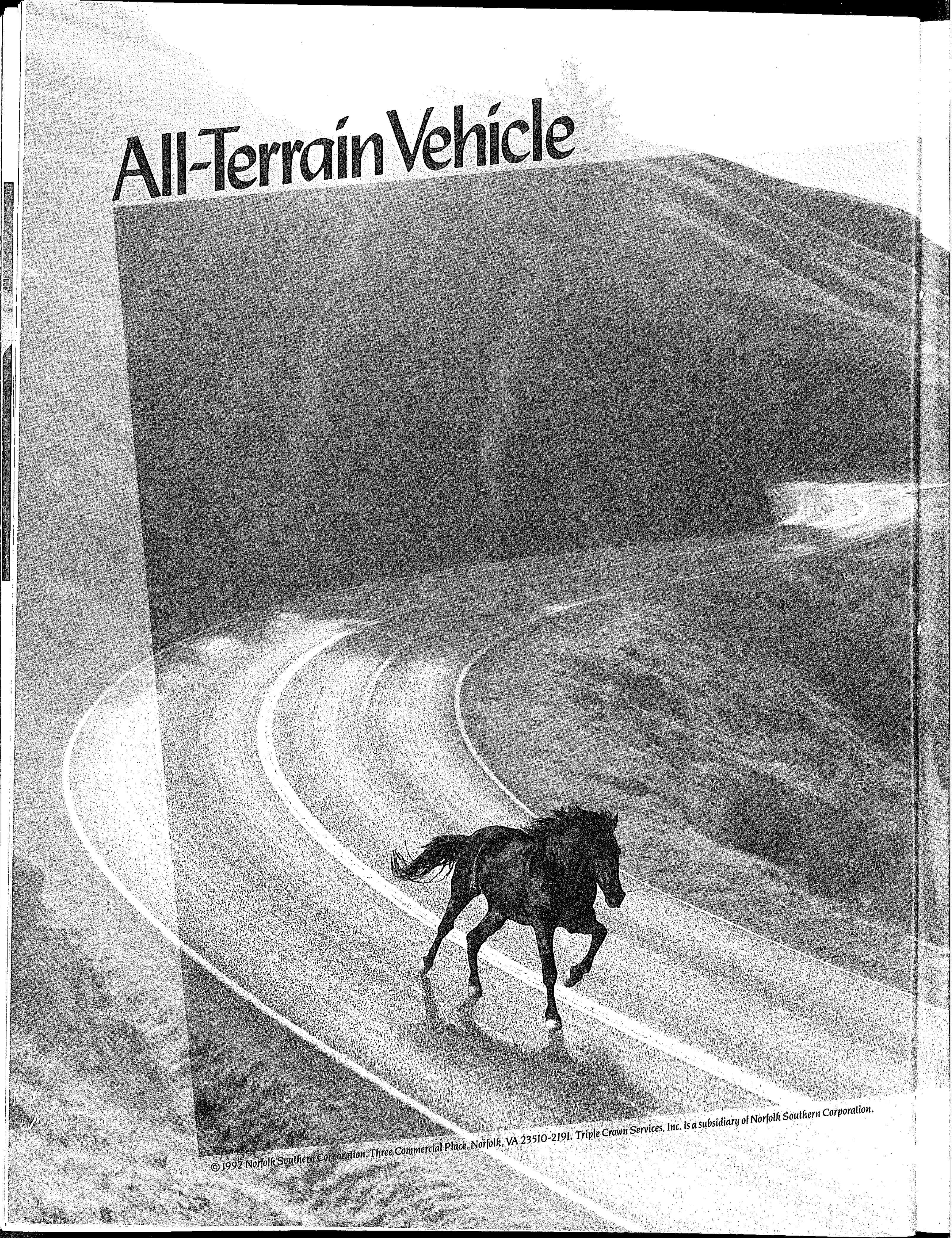
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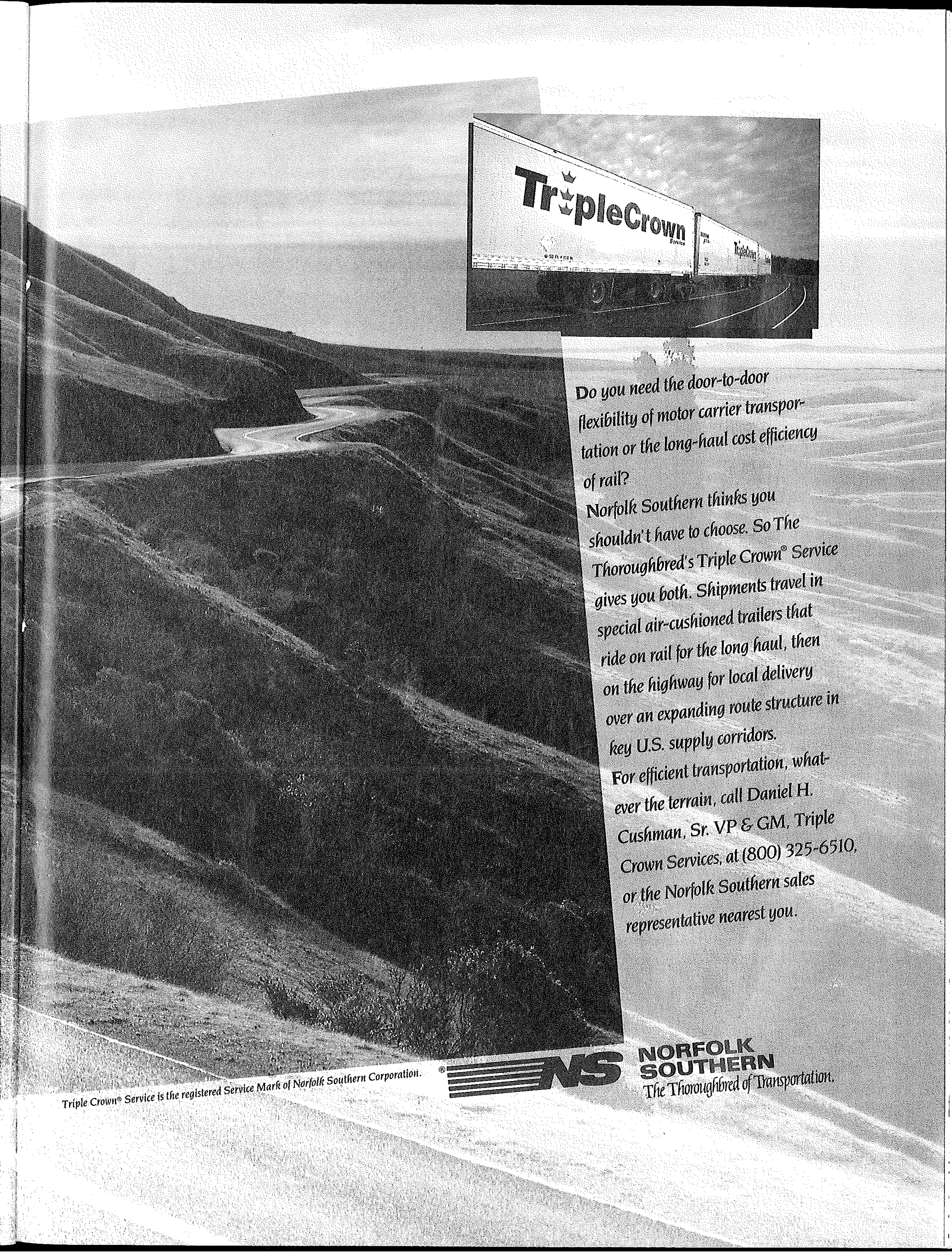
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ing Carling O'Keefe Breweries for around $300 million. Ted Kunkel was sent out to run Carling.

Carling was Canada's third-largest brewer, with 20% of the market. Kunkel approached larger rivals Labatt and Molson about acquiring one of them but was rebuffed; however, Molson Cos., a diversified company, agreed to a joint venture, merging its brewing operations with Foster's Carling O'Keefe. Today the joint venture, Molson Breweries, created in 1989, has 52% of the Canadian market.

"The synergies between the two companies were almost abnormal, as if somebody had planned it," Kunkel marvels. For example, in Montreal Molson had a very modern and efficient brewery, while Carling's brewery was old. In Toronto Carling had the best facilities, while Molson's brewery on the waterfront had great value as real estate. All the synergies added over $150 million to earnings before taxes and interest.

Between fiscal 1990 and 1992, according to ANZ McCaughan brewing analyst Terry Povey, Kunkel increased Molson's margins from 8.5% to 13.9% in the midst of a severe recession.

In Britain, too, Foster's British company, Courage, was plowing ahead. In 1991 Courage acquired the brewing operations of Grand Metropolitan Plc., making it a powerful second in the U.K. It also set up a separate joint venture, Inntrepreneur, to manage 8,450 of the two companies' own pubs.

Through the years, Foster's has shown a remarkable ability to maintain an amicable relationship with other brewers. In the U.K., for example, Foster's brews both Miller and Budweiser—at opposite ends of the same brewery. In Canada the Molson joint venture brews Miller and Coors. And, although Molson is a rival of Dutch brewer Heineken N.V. for the U.S. import market, Molson brews and distributes Heineken's Amstel brands in Canada.

So how does all this translate to the bottom line?

In fiscal 1992 Foster's brewing operations had operating income of more than $400 million, up 13%, on a 9% increase in revenues, to about $5.4 billion. Margins on the brewing operations are improving, although they are less than half those of Anheuser-Busch Cos. and only slightly better than Miller's. Clearly, the Foster's board hopes that Kunkel can work his Canadian magic with the rest of Foster's operations. Equally clearly, there is plenty for him to do.

John Gollings

Sampling of Foster's brews

A powerhouse competitor on three continents.

In the U.K. Foster's has lost a lot of business because brewers are no longer permitted to use as many of their own pubs as exclusive captive outlets for their own beers. In Australia Foster's is in a price war for market share that has eroded its margins. Distracted by the corporate infighting, Foster's lost some market share and is trying to regain it. But price-cutting goes very much against Kunkel's grain. "I'm not a discounter," he says. "I'm a brand builder."

So Kunkel is likely to focus on cutting costs and improving marketing as means of restoring profit margins, rather than using price as a weapon. He says: "The thing that you can do in poor times is effect changes in structural costs that are not as easy to do in good times."

Meanwhile, in Canada there is the recent alliance with Philip Morris. Last month Miller announced it had agreed to purchase 20% of Molson Breweries for $273 million plus the net book value of Molson's U.S. assets. It will take over the distribution of the joint venture's products in the U.S., giving it far greater reach in domestic markets.

By giving it additional brands, the move will also help Miller, whose market share has stagnated during the past decade; industry leader Anheuser-Busch has steadily pulled away and currently has double Miller's share.

Miller's move raised some intriguing possibilities. Within the last two months, the company has bought stakes in the largest brewers in Canada and Mexico. Miller President John MacDonough has said the company would move aggressively to strengthen its international business. Its parent, Philip Morris, is brimming with cash; it has estimated it will generate $21 billion in cash in excess of internal needs between 1992 and the end of 1996, and has lots more in borrowing power. It is obviously ripe to make an acquisition.

Could Foster's be it? With a current market capitalization of $3 billion (traded in the U.S. as ADRs), Foster's would be a fairly cheap acquisition. With that single move, Miller Brewing would make up a lot of ground on Anheuser-Busch, besides putting itself years ahead of its rival in global penetration.

For the first half of fiscal 1993 (through December), Foster's is expected to announce slightly lower sales and brewing income, reflecting the worldwide recession. But that down blip does little to lessen the company's powerful position in the international beer market. The people at Australia's Broken Hill made a smart move when they seemingly threw good money after bad to strengthen their stake in this once troubled Australian company.

Connecticut: The State That Thinks Like A Business.

Running a business today is tough work. The last things a business owner needs are bureaucratic walls to get around, a tangle of regulations that sap dollars from the company's bottom line.

Connecticut knows the kind of obstacles businesses face and has taken dramatic steps to knock down those walls. First, Connecticut bit the bullet and balanced its state budget. No longer will the state use regulations as a club to drum up income. Instead, the state legislature created a fair, equitable tax system that doesn't punish business.

To dispense with the credit barrier, the state established a billion-dollar loan and loan-guarantee program—$200 million in state funds which leverages $800 in bank money—to bring new businesses into the state and expand companies already there.

Then the state took on its own bureaucracy, streamlining the process by which businesses get up and running. Businesses now deal with different state agencies through one contact person. They get fast-track movement through the permitting process. And they can tap into a wealth of programs, from job training to export assistance.

With those obstacles out of the way, businesses can now enjoy the assets that have traditionally made Connecticut a superior place to do business: its highly trained work force, its ready access to the growing international markets, and its incomparable quality of life.

Nick Perna, chief economist Shawmut National Corporation

"Connecticut is poised for the future. They've reduced the business tax burden, balanced their budget, maintained their credit rating and introduced one of the most innovative programs in the country to ease the credit crunch."

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- it ranks eleventh for number of scientists and engineers in the work force;
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Connecticut workers are not only talented and well-trained, but highly productive. And the state has invested in this strength through innovative partnerships with the business and academic communities. Per capita, Connecticut ranks sixth in the nation in R&D expenditures at universities.

Connecticut's Global Vision

Connecticut has positioned itself to compete vigorously in the global markets. The state leads the nation in the export of manufactured goods per capita. Overall, exports are growing at a rate of 10% per year.

Connecticut paved the way ten years ago for this explosion of growth by a bold investment in its infrastructure. Today, Connecticut's expressways and highways, its ports and airports, its rail lines and telecommunications systems are among the most modern and well maintained in the U.S. No wonder that more than 100 U.S. and international companies have set up regional distribution centers in Connecticut.

Companies desiring to enter international markets will have a leg up in Connecticut. The state's aggressive new international program provides counseling on everything from markets to documentation to shipping.

Good Things Come in Small Packages

Every state talks about its quality of life. But what does that mean? In Connecticut, quality of life means an opportunity to take a class at a world-class university like Yale or Trinity or University of Connecticut. It means enjoying a dramatic production at one of the nation's top regional theaters. It means superior public and private schools for children and high quality, yet affordable, health care.

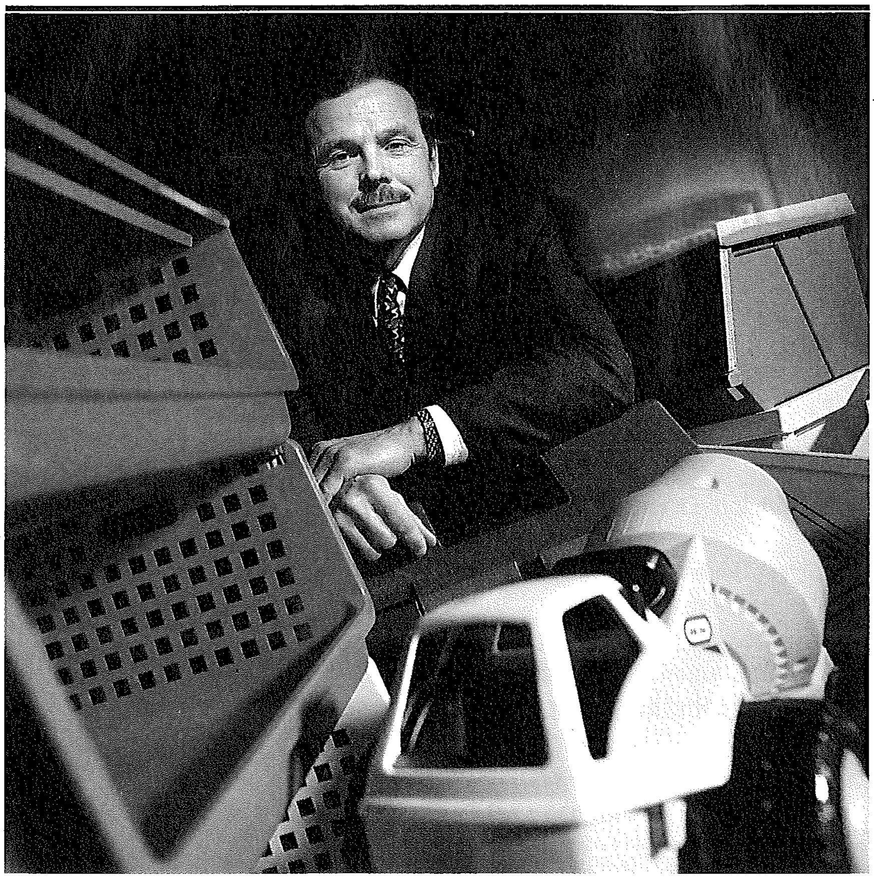
Quality of life also means a temperate climate, four seasons and striking geography. It means hunting, fishing, skiing and hiking, all within easy reach. "I can get off work at 5:00, and by 5:30, I'm out on the Sound chasing lobsters," says James F. Crowe, executive vice-president at United Illuminating, one of the state's utilities.

Whatever one's definition, quality of life combines with Connecticut's other assets to produce the perfect climate for business. Learn more about the State That Thinks Like a Business. Call 1-800-392-2122.

Billions of dollars in stock market value ride on Wolfgang Schmitt's ability to keep Rubbermaid growing the way Stanley Gault did.

Okay, call me a predator

By Seth Lubove



Jack Van Antwerp

Wolfgang Schmitt, Rubbermaid's new chief executive

"Where is it written that garbage cans can't be fashionable?"

AS A HIGH SCHOOL track star at Smithville (Ohio) High School, Wolfgang Schmitt set a school record for the 180-yard low hurdles that still stands 31 years later. Fit and intense at 48, Schmitt is trying to get Rubbermaid Inc. over some tough hurdles.

Founded in the 1920s as a toy-balloon maker, Wooster, Ohio-based Rubbermaid is one of the business world's recent success stories. Stanley Gault, son of Rubbermaid's first general manager, left a fast-track job at General Electric to take over as Rubbermaid chief executive in 1980, and turned a faltering little company into a $1.8 billion (1992 sales) business.

Rubbermaid's return on equity has averaged 20% in recent years, and without benefit of capital leverage in the form of debt. It enjoys a market capitalization of $5 billion—nearly three times revenues.

Gault made Rubbermaid such a household name that four years ago consumers thought it was the number two maker of dishwashing gloves even before it made the gloves.

Gault went on to head Goodyear Tire & Rubber Co., handing the reins in 1991 to Walter Williams, 58. But Rubbermaid's earnings growth slowed in 1991 from the usual 15%. Williams resigned unexpectedly last November, trailed by nasty newspaper articles that accused him of steering contracts to cronies. The charges are hotly denied by Williams and the company. Schmitt says that Williams quit for "personal reasons" and to spend time with a brood of ten grandchildren.

Nevertheless, the rumors and the slowdown in earnings growth tarnished Rubbermaid's image. The stock, which sold as high as 37⅜ in January 1992, dipped as low as 27 before returning to a recent 31⅛.

To restore confidence, Gault stepped back in as cochairman, while keeping his full-time job as chief executive of Goodyear. Schmitt, who had been chief operating officer under Williams, became cochairman and chief executive officer. Gault is working only part time, so the task of steering the company falls to Schmitt.

Schmitt will have to do more than just restore Rubbermaid's image. With the recession pinching consumers' incomes, Rubbermaid is losing more sales to cheaper, nonbranded goods made overseas.

At the same time, having saturated the kitchen with such ubiquitous plastic creations as Servin' Saver food containers and Chef Spaghetti Scoops, Rubbermaid must find new markets. It is now going after the rest of the house, the backyard and, lately, the office. Rubbermaid has also expanded overseas, where it hopes to garner 25% of its sales by 2000, up from 15% now.

Schmitt faces an odd problem: Their quality is so high that Rubbermaid products infrequently need replacing. So the company must depend on new products—and new mar-

kets—for growth. Schmitt says he wants to add a new market segment every 12 to 18 months.

It's a tough job but not undoable. "We're literally limited by our imagination," Schmitt boasts. Over 30% of Rubbermaid's sales come from products introduced within the past five years. To keep copycats at bay, Rubbermaid does no market testing; it would give others too much time to look at and knock off the new product. Instead it uses focus groups to identify needs. Then it develops a product and rolls it out.

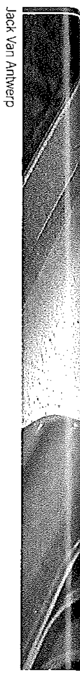
One example: Rubbermaid designed a step stool with a toolbox fitted in the top step to reduce the need for storage space. Whereas the rule of thumb is that 90% of new consumer products fail, 90% of Rubbermaid's new products succeed. Last year Rubbermaid averaged a new product every day, a record Schmitt wants to surpass.

Rubbermaid counts heavily on a new generation of computer-aided design (CAD) workstations so advanced that they reduce new product design time from months to days.

Schmitt turns reticent when asked for more details; competitors have big ears and big eyes. But essentially the workstations enable Rubbermaid to go directly from rough sketches to finished product in weeks rather than months. "We're moving from sequential to simultaneous design," says Thomas Hanna, manager of product development for the Home Products Division. "We're ultimately able to reduce cycle time, decrease duplication of effort and reduce errors." Reducing the cycle time is critically important: Rubbermaid has the

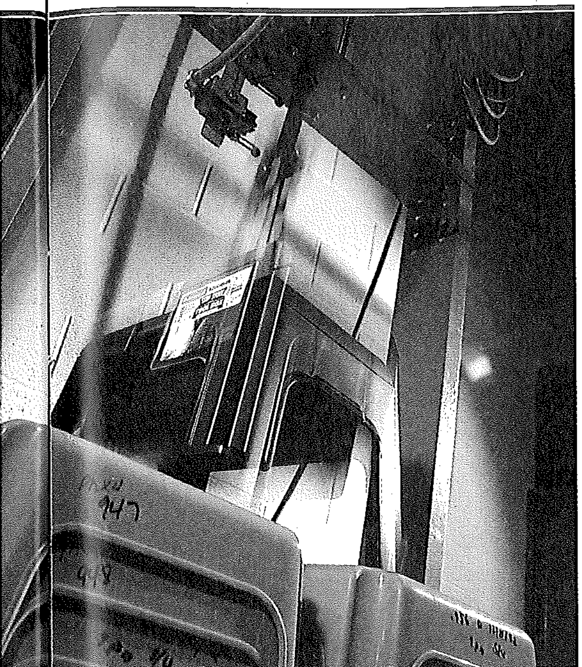
Roger Mastroianni

LEFT:
Stanley Gault, former Rubbermaid chairman
Back temporarily, and part time, to restore confidence and smooth the transition.



Jack Van Antwerp

RIGHT:
Roughneck step-stool toolbox
An average of a new product a day, but no market testing.



market to itself for longer before cheaper knockoffs appear, and it can respond to new market opportunities faster.

Schmitt plans to convert the whole company to the new CADs this year from an older system. This means writing off a big investment in old CAD systems.

"For us to be successful, we have to reinvent ourselves continuously," Schmitt says. "If we don't, our profit-generating capacity will diminish." The reinventing can be expensive: Rubbermaid once spent $1 million just to retool an ice cube tray injection-molding machine so that it could accommodate a new kind of plastic that makes it easier to remove the ice cubes.

Filling Stanley Gault's shoes isn't easy, as Walter Williams learned. But Schmitt is up to the task. Born in 1944 in war-torn Germany, he came with his parents after the war to bucolic Smithville, only 5 miles from Rubbermaid's offices. Still fluent in German, Schmitt joined Rubbermaid in 1966 as a management trainee, straight out of Westerville, Ohio's Otterbein College, a Methodist institution. He moved through a series of management jobs, including director of research and development for Home Products, and to executive vice president in 1987.

Despite his small-town background—or maybe because of it—he's imaginative as can be when it comes to marketing. For instance, he asked his designers a few years ago why garbage cans must be made only in chocolate and olive green. Why not blue? "I said, where is it written that garbage cans can't be fashionable?" Schmitt recalls. Rubbermaid now sells more blue garbage cans than any other color. A collector of Southwest Indian artifacts, he steered Rubbermaid into making things in trendy Southwest colors such as terra-cotta and turquoise blue.

It takes a tough man as well as an imaginative one to run a tough business like this, and Schmitt fits the bill. An aggressive tennis player with a killer serve, he just smiles when he's reminded that competitors accuse him of predatory behavior—defined in this case as consistently beating them to market. "If our competitors think that, I take it as flattering," he says. "We love the free enterprise system. We live in a system where the making of a profit is ethically legitimized because the consumer is rewarded with better value. Yes, I love it if they call me a predator for those reasons."

A new accounting rule makes financial statements difficult to compare—and gives managements a new way to massage earnings.

Read those footnotes!

By Roula Khalaf

HIDDEN RESERVES, which allow managements to smooth out reported earnings, are making a quiet comeback. Their vehicle: the Financial Accounting Standards Board's new Statement 109, which tells companies how to account for tax credits. Some companies have already adopted the new rule, but most will adopt it by the first quarter of 1993.

Suppose that as the result of a big restructuring, a company generates a $1 billion loss. For tax purposes, losses can be carried forward for 15 years. Assuming the company makes money after the restructuring and pays taxes at the full corporate income tax rate of 34%, that $1 billion loss could save the company $340 million.

The accounting question is: When and how should the company account for that potential tax savings?

According to the FASB's Statement 109, managements must peer into the future. If management believes it is "more likely than not" that the company will generate enough earnings in the future to warrant the use of the credits, then the company must book the value of the tax credit as income immediately, and label the earnings infusion as a one-time accounting change.

What if management isn't so sure about future earnings? Then Statement 109 tells the company to set the tax credit aside in a reserve. This reserve can be dipped into in future years at management's discretion—and thus could be used to offset earnings disappointments.

Companies looking to set up tax credit reserves won't encounter much resistance from their auditors. That's because Statement 109 gives managements a great deal of latitude as to the outlook for future earnings. "The 'more likely than not' provision is perhaps the most judgmental clause in accounting," says Ernst & Young partner Norman Strauss.

Statement 109 certainly won't make it easy to compare companies' financial statements. Consider how computer systems maker Unisys (1992 revenues, $8.4 billion) and information services provider Ceridian (estimated 1992 revenues, $825 million) are following the new rule.

Companies to watch

Company	Net operating loss carryforward* ($millions)
Armco	$1,031
Black & Decker	596
Data General	490
Michigan National Corp	215
Occidental Petroleum	990
Penn Central	940
PHM Corp	638
Southland Corp	916
Temple-Inland	598
Wang Laboratories	1,800

*For financial reporting. Numbers as of most recent fiscal year available.

All these firms have large operating loss carryforwards that can reduce taxes in future earnings periods.

As a result of its 1991 restructuring, Unisys is sitting on tax-loss carryforwards that could save it up to $500 million (about $3 a share) in taxes. Unisys management believes the earnings outlook is reasonably bright; therefore Unisys will book most of its tax credit as income up front. The company recently said it will record a one-time gain of between $325 million and $425 million in its quarter ending Mar. 31. The remainder of the credit will most likely go into a reserve and could be taken into income slowly, over the next several years.

Now look at Ceridian, which is the successor company to the moneylosing computer systems maker Control Data. Last year Ceridian spun off its unprofitable operations, leaving it with a profitable core business in information services—and tax credits worth over $450 million, about $10.60 a share. Ceridian will book its $450 million tax credit as a reserve, and take a fresh look at the reserve after several profitable years.

Result: Unisys' reported net income will get a big, nonrecurring infusion this year. Ceridian's aftertax earnings will get nothing this year but could instead enjoy a steady stream of infusions in the future—assuming, of course, Ceridian makes money.

Not all companies will rush to set up reserves. Those trying to build their capital accounts—banks, for example—will attempt to recognize as much of a gain as possible early; most of the gain will flow into the balance sheet as retained earnings. Others, faced with huge charges against earnings to fund reserves for retiree health benefits, will also want to book big gains immediately to mitigate the negative impact of these charges on equity. But other companies will set up reserves and use the reserves to offset unwelcome charges—or simply to make a particular quarter's earnings look better.

"With Statement 109, accounting rulemakers have created an incredible earnings management tool," charges Shearson Lehman Brothers tax and accounting expert Robert Willens. "This reserve is a mass with which you can do whatever you want."

Morale: Starting next month, read those income tax footnotes extra carefully.

Super Food Services' Jack Twyman thought he was immune to the changes sweeping the food wholesaling industry. Then Albertson's pulled the plug.

Dinosaur?

By Toddi Gutner

PUT Basketball Hall of Famer Jack Twyman on the court today and he would be more than a little out of his depth. Basketball has changed since Twyman was a star forward for the old NBA Cincinnati Royals, from the mid-Fifties to the mid-Sixties. For example, players can no longer hang around the basket waiting for a pass to slam-dunk the ball.

Twyman's industry, food wholesaling, has changed, too. But Twyman isn't doing a very good job of adapting to the changes. As a result, the company he has run since 1972, Dayton, Ohio-based Super Food Services, Inc., is threatened with extinction.

Last year Twyman's largest customer, Boise, Idaho-based Albertson's, Inc., ended an 18-year relationship with Super Foods. Losing Albertson's cost it 34% of its $1.8 billion in total revenues in a single stroke. Losses for the fiscal year ending last August came in at $5.5 million (51 cents a share), compared with 1991's net income of $12.2 million.

Observes an executive at one of Super Foods' competitors: "Twyman thought Super Foods was insulated from the industry trend, and specifically Albertson's plan, toward self-distribution." But as managers of businesses in dozens of industries are finding, no one is safe from change.

Losing Albertson's came as a complete surprise to Twyman. It shouldn't have. Food retailers operate on razor-thin margins. To fatten them up, Albertson's and other big grocers have for years been building their own supply networks and cutting out wholesalers like Super Foods.

Other big wholesalers have adapted to this trend. For example, the nation's largest food wholesaler, Minneapolis' $15 billion (sales) Supervalu Inc., now does much of its business with small, independent grocers, and has developed several chains with a total of 260 retail grocery stores.

Why didn't Super Foods do likewise? "Albertson's didn't want us to," replies Twyman. "Our philosophy was to remain a food wholesaler and not go into competition with our customers, and I think they appreciated it." But not enough to restrain Albertson's from going into competition with Super Foods.

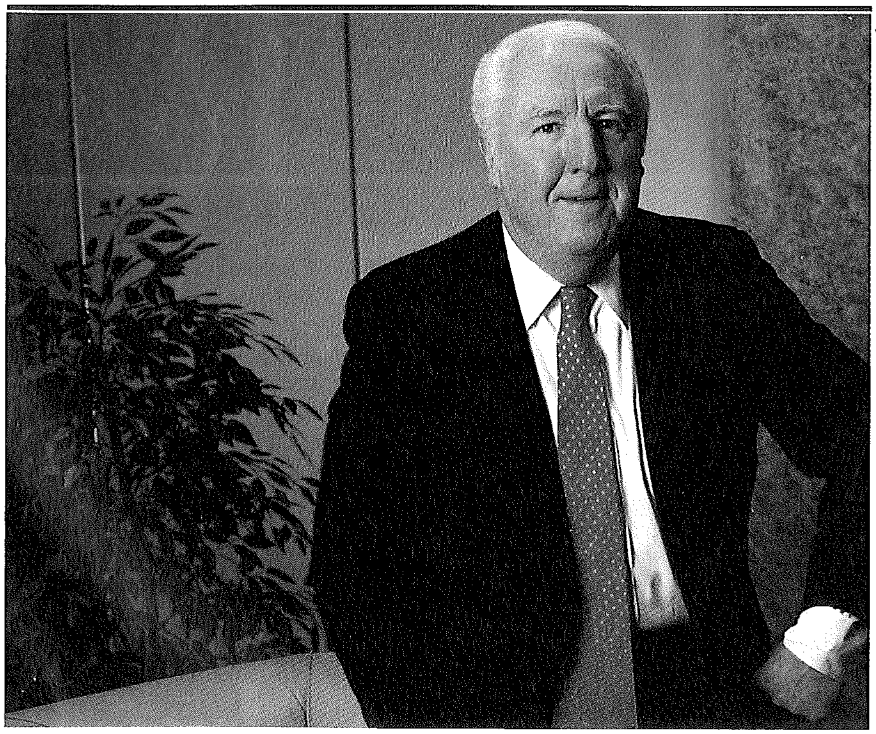
Twyman should have heard a penny drop in 1989, when Albertson's began to phase out Fleming Cos., another big food wholesaler. That phaseout would leave Super Foods as Albertson's only significant outside supplier in the U.S. (in the important Florida market, where Albertson's then had 66 stores).

Another penny dropped in 1991 when Warren McCain, Albertson's chairman and chief executive for 14 years, retired. Twyman's friend and golfing partner, McCain probably would have continued doing business with Super Foods. But McCain's successor, Gary Michael, was determined to accelerate Albertson's plan to eliminate its middlemen. With many stores in Florida, Michael had plenty of reason to move quickly in the state.

Why didn't Twyman pay closer attention to the warning bells? Perhaps his earlier successes convinced him that he could survive where other wholesalers were failing.

His record was indeed impressive. In the early 1980s Twyman invested heavily in technology and made Super Foods into a much more efficient and profitable company. Super Foods' margins grew from 0.3% in 1982 to 1% in 1990, and net income rose from $3.6 million to $17.2 million, increasing earnings per share nearly five times, from 34 cents a share to $1.60.

The stock peaked at 22 a share in



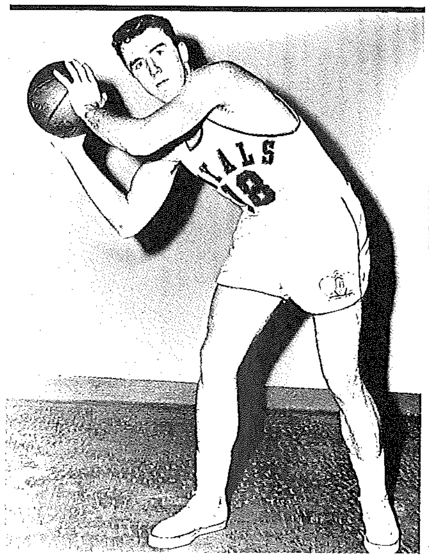
Andy Snow

Jack Twyman, Super Food Services' chairman and chief executive
"Our philosophy was to remain a food wholesaler."

1989. Today, however, it trades at 11, up from a recent seven-year low of 8⅝. At the current price, the company is valued at just 9% of its $1.3 billion likely revenues this year. Competitor Supervalu sells for 16% of its revenues.

These days Twyman is spending a lot of his time with lawyers. Over the years Super Foods invested some $110 million in its distribution center in Orlando, Fla. The goal was to better serve Albertson's Florida stores. When Albertson's pulled out, Twyman closed the Orlando operations and took a $23 million charge against earnings. Twyman claims that the facilities were custom-built at Albertson's request, and is now suing Albertson's for breach of contract.

The lawsuit also accuses Albertson's of breaking an agreement to purchase Super Foods' Florida distribution assets and inventory for $60 million to $80 million. This agreement was made in February 1992, after Albertson's decision to move to self-supply. But Albertson's lawyers point out that the agreement was contingent on a new collective bargaining agreement between Albertson's and the International Brotherhood of Teamsters. A new contract was never ratified, so Albertson's claims it is off the hook for Super Foods' Orlando assets. The dispute eventually will be settled, but when and for how much no one can say.


Naismith Memorial/Basketball Hall of Fame

Jack Twyman, star forward and Basketball Hall of Famer
The rules of the game changed.

Apart from its courtroom strategies, how does Super Foods plan to recover? Twyman says he plans to lure customers away from competitors and make acquisitions of small regional wholesalers with sales in the $100 million to $200 million range. He also hopes to increase the amount of merchandise existing customers buy from Super Foods.

In 1991 Super Foods acquired Lexington-based Kentucky Food Stores, a regional food wholesaler that Twyman hopes to expand. But with only $16 million in cash and a stock that's hovering around book value, financing more acquisitions won't be easy. Indeed, Super Foods itself is an attractive target—there is only $54 million in long-term debt, and the company can probably earn $1 a share on its shrunken revenue base. Insiders, including Dayton's wealthy Berry family, control just 8% of the stock. But right now Fleming and Supervalu, the two companies most likely to go after Super Foods, are both digesting recent acquisitions.

"We are survivors," Twyman gamely insists. But when companies fall behind in a fast-changing industry, catching up is hard to do.

Do you really know how much you are paying in fees when you invest in a mutual fund? Here's how to avoid getting nicked by fee-greedy fundsters.

Fee

By Jason Zweig and Mary Beth Grover

IT SHOULD BE a buyer's market out there for mutual funds. Everybody wants to get into this extremely lucrative business, and almost anybody can get in: There are already 4,000 funds clamoring for investors' attention. New ones are rolling off the assembly line at the rate of one a day.

But all this creates a problem for even the most sophisticated investors. It is getting harder and harder to know how much you are paying for the fund manager's services. The fact is that some fund managements are getting ever more imaginative in soaking the customer. They often do so by confusing investors with complexity.

By our count, there are now nine different ways to reach into the fund buyer's pocket. We'd be surprised if the number didn't increase before year's end.

How do you, the investor, know whether you're paying too much for the fund manager's services? Here's our definition of a bad buy: a fund that costs 2% a year for the time you hold it. Our definition of a really bad buy: a fund that eats away 3% of your money per year.

Illustrations by Gary Hallgren

You can easily blunder into such a situation if you pay a load and leave quickly, or if you happen into a fund with an unusually high annual expense ratio.

Shearson's Advisors Fund, for example, runs an annual expense ratio of 3.86%; on top of this drag on performance there is a one-time sales commission that goes as high as 5% (on an investment of $100,000 or less).

The Kaufmann Fund and the Prudent Speculator Leveraged Fund assess no sales loads but run annual expenses that are above 3%.

In the merely bad category are scores of funds with annual expenses over 2%.

What's so bad about a 2% fee for professional money management in a market that seems to be shooting up 15% a year? Just the fact that you can't count on that 15% for very long. Remember: You will still be nicked 2% if the fund loses money for you. With the market at an extremely high valuation by historical norms, it's reasonable to assume that stocks are due to deliver real (after inflation) returns of only 6% a year—before expenses, that is. A bad-buy stock fund, then, is fixing to take a third of the real money you can expect to earn on your investment. Or to aggravate any losses the fund may incur in bad markets.

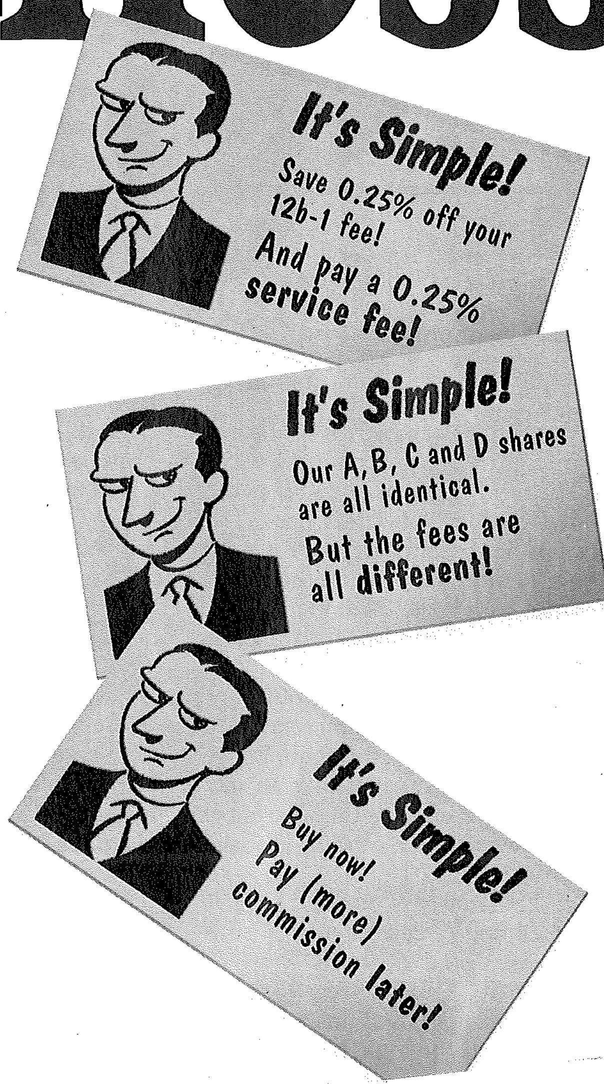
Bond funds are not immune to these hidden costs. Given current inflation and interest rates, the real return on medium-to-long-term U.S. Treasury bonds will be about 4%. Bad-buy Treasury funds are gobbling up half your prospective earnings.

For decades this magazine and others have been educating the investing public about the virtues of comparison shopping for funds. Unless you really need hand-holding by a stockbroker, we have said, buy a no-load. You can usually find one to suit any need.

That message has finally sunk in, but load fund groups, confronted with clients who are wary of upfront sales commissions, are firing back with a dizzying assortment of other fees that accomplish the same purpose. A fund might eliminate its upfront sales charge but then throw in a 12b-1 fee to finance marketing and distribution costs. Or maybe it offers you a deal: We'll lower your annual 12b-1 fee by a quarter of a percentage point, but then we'll tack on an identical amount for "servicing."

The game board started getting really messy in 1988, when Merrill Lynch introduced dual-class shares in virtually all of its retail funds. The Class A shares carry a maximum 6.5% front-end load—every $1 you put in buys

Madness

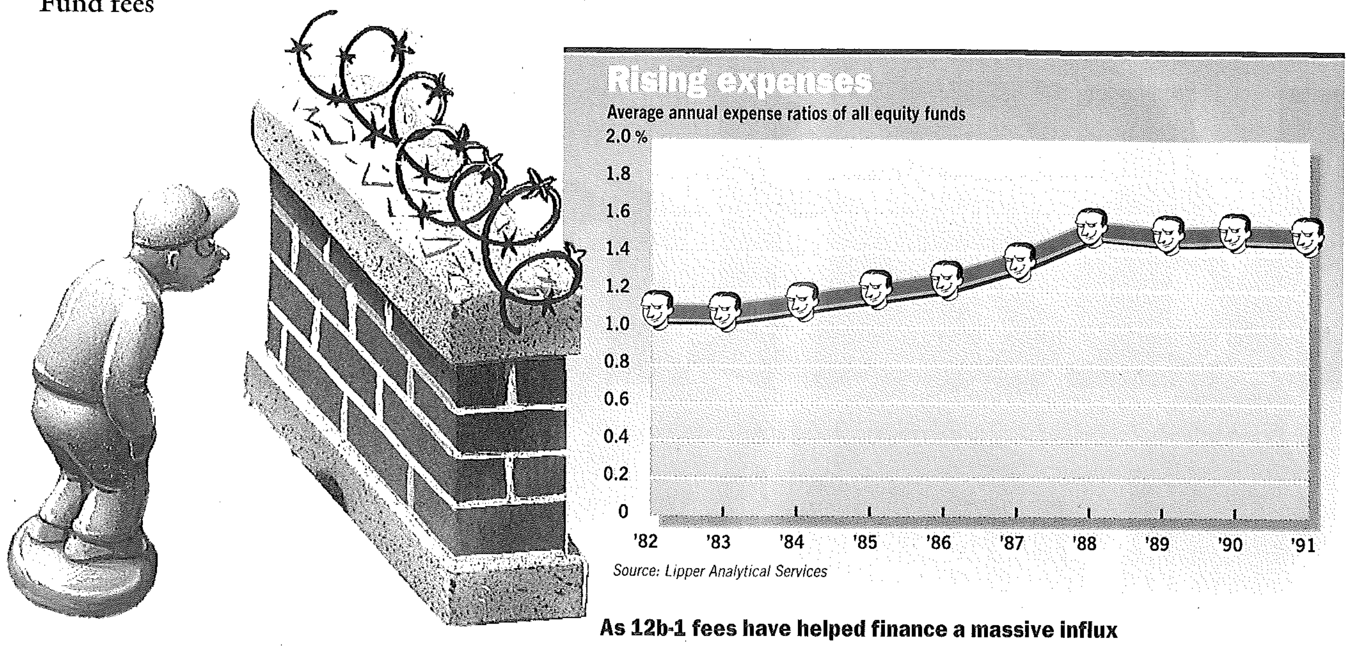


you 93.5 cents worth of fund shares, the rest going to the broker. The B shares carry no front-end load—$1 buys you $1—but the broker gets you on the way out. When you redeem a B share you could leave up to 4% with the broker. The idea of paying the load later seems to have big appeal. B shares are selling like hotcakes, and last year the Securities & Exchange Commission received 44 requests from fund companies to approve new multiclass shares.

In 1991 and 1992 PaineWebber thickened the alphabet soup with C and D shares. The C's have no load and no 12b-1, while the D's have no load but charge 1% in annual 12b-1 and "service" fees. The C's, of course, would be the best deal. But you can't buy them, unless you work for PaineWebber.

This labyrinthine game, so bewildering to the consumer, is a jackpot for fund companies and brokers. Last year, says Financial Research Corp. of Chicago, 60% of the multiclass funds sold by brokers—some $17.3 billion worth—went into these new classes of shares. "That's a pretty compelling number when you consider that a lot of fund families just introduced them last year," says financial services consultant John Keefe.

Broker-sponsored funds are not the only ones confusing investors. Last month Dreyfus Corp. got the SEC's blessing to issue at least two classes of shares for all of its funds.



As 12b-1 fees have helped finance a massive influx of shareholders, fund expenses should have come down. No such luck.

Fidelity, which sells mostly low- and no-load funds over the phone, is trying to keep its distribution options wide open. The fund giant has obtained permission to issue "an unlimited number" of classes.

This business is getting so out of hand that newspapers around the country are asking the Associated Press, which collects daily fund data, to limit its listings. Says Jill Arabas, who helps oversee fund tables at the AP: "The papers are freaking out, saying, 'Stop! We don't have room!' "

Don't look for any rescue from the folks who run the funds. Ostensibly, fund directors are there to represent your interests. They are, for example, supposed to approve 12b-1 assessments (named after an SEC regulation allowing them) only after determining that existing shareholders benefit when some of their money is spent to attract new customers.

With 12b-1 charges, funds can attract more customers and a greater pool of assets over which to spread fixed costs like legal and accounting fees—or so goes the logic behind the rule. Curious thing is that after years of ever more common 12b-1 plans, equity fund expense ratios refuse to come down *(see chart, above)*.

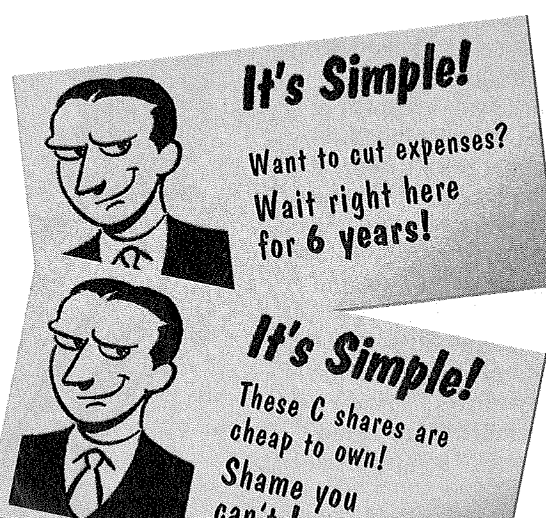
Today 40% of equity funds carry 12b-1 fees. It's big business. In the first three quarters of last year, Dean Witter, with $58 billion in fund assets under management, earned more from 12b-1s—$175 million—than it did from management fees.

Just how does the fund industry play Fee Madness? Let's flip over some of the cards.

Buy now, pay later. Once called back-end loads, these shares, usually rechristened as Class B shares in multiclass funds, carry a higher 12b-1 fee than Class A. The typical Class B shareholder incurs a load only on selling the shares; this back-end load falls from 5% or 6% to zero within five to eight years. Many B shares convert to Class A at the end of this waiting period.

Brokers push these funds as quasi-no-loads. Yes, there's a sales commission, but stick around long enough and you don't have to pay it. That's how most short-term global bond funds were flogged last year. When investors stampeded out after Europe's currency upheaval last fall, they suddenly found themselves paying loads they had forgotten about. The loads accentuated their losses.

Among the big buyers of B shares are bank customers fleeing certificates of deposit. "It's easier to sell them funds that have the appearance of no-loads," says consultant Keefe. Last year, for example, 50% of Putnam's B shares were sold to bank customers.



Do the buyers know what they have gotten into? Many do not. Warns Tom Decker Seip, mutual fund chief at Charles Schwab: "As surely as the sun rises tomorrow, you can bet that if interest rates go up and bond fund prices fall, people will be screaming that their salesman didn't tell them about the back-end load."

Even if the funds do well, people will be screaming about the paperwork. Take

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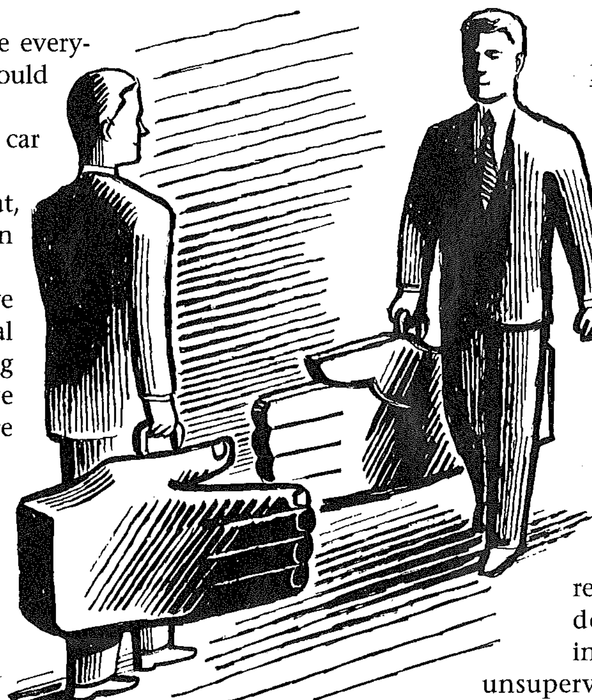

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the befuddling bifurcation of Kemper Growth Portfolio, an equity fund that is split into "initial" and "premier" shares. The initial shares charge a 0.75% 12b-1 fee—that is, the investor is nicked 75 cents per year for every $100 invested in the fund. The premier shares do not pay this annual charge. Initials convert to premiers after six years. The two classes have separate daily net asset values and different returns.

And what if you buy a little of the fund every month? Each purchase is tracked separately, has one of three different back-end loads, depending on when you sell, and converts on a different date. Tell that to your accountant when you make a partial withdrawal from the account.

Buy now, pay forever. Welcome to the world of "level-load" shares. Getting into one of these funds is like getting trapped in a taxi with the meter running. Pioneered by Thomson and PaineWebber, this kind of fund is being considered by Alliance, Colonial, Putnam and others. Most level-load shares charge no front-end load but an annual 0.75% 12b-1 and a 0.25% service fee—forever. Both these charges are added to the regular management fee, which alone can easily top 1% a year.

Who sold you this thing? Then there are the ASO Outlook funds managed by AmSouth Bancorp. of Birmingham, Ala. According to a November SEC filing, these include: Class A, sold through AmSouth branches or outside brokers, carrying a front-end load yet to be determined and a maximum 0.40% 12b-1 fee; Class B, sold mainly to other financial institutions, charging no load but carrying a 0.25% 12b-1 fee; and Class C, sold through the bank's trust department, charging no load and no 12b-1. Buy through a broker, buy through a bank or buy through the trust department: different fees each time.

Pay twice. Fund shareholders may find themselves paying for a broker's "services" years after forking over a sales commission. In January Seligman piled on a maximum 0.25% annual service fee for the benefit of the chap who sold you the fund; this is on top of the maximum 4.75% front-end load shareholders had already paid.

Get a price cut, and still pay the same. Buy Eaton Vance's new Greater China Growth Fund, and you pay a 0.50% 12b-1 fee in the first year. The second year, your 12b-1 fee drops to 0.25%, but a 0.25% "service fee" miraculously appears. Even if you fire the broker, you still pay the fee.

Pay to stay. Most fund operators are thrilled to have customers reinvest their dividends—it gives them more assets on which to assess management fees. Franklin Resources, though, charges investors in most of its bond funds a 4% commission to reinvest their income dividends. Of Franklin's $331 million in fee revenue in fiscal 1992, close to $30 million came from dividend loads. A handful of other funds assess reinvestment loads.

Pay à la carte. Fidelity's Spartan funds have low annual expenses (lower than other Fidelity funds, anyway) but charge customers with less than $50,000 a $5 fee for each withdrawal or transfer.

Pay a flat load. Is the Blanchard Short-Term Global Income Fund a no-load? Blanchard will sell you shares directly with no sales charge—but you will have to fork over a $75 "account opening fee." On the minimum $3,000 investment, that's the equivalent of a 2.5% load.

A sister to the flat load is the flat annual expense charge. Thus, the Vanguard Extended Market Portfolio boasts of its low 0.19% annual expense ratio but doesn't include the flat $10-a-year account maintenance charge. On a $3,000 minimum investment, this $10 fee almost triples the published expense ratio, to 0.52%.

Pay a surprise increase. The Scudder Medium Term Tax Free Fund charges no annual expenses at all. What is this, a charity? No, just a come-on rate. Scudder is temporarily absorbing costs totaling 0.77% a year. The sale could end as soon as June 30—or maybe not. Sponsors of at least 522 funds are absorbing expenses. They figure inertia will keep the customers even after the sale is over.

If all this sounds like nickeling-and-diming and not worth getting exercised about, consider this: The difference between 1% in fund expenses and 2% can make a mighty difference in your long-term return. Assuming stocks deliver their historical return of 10%, over ten years that extra charge will reduce your return by more than $2,250 on a $10,000 investment. The relative damage could be far greater if—as is not at all unlikely—the market hits some bad patches over the next few years.

So stick to funds with low overall costs. Keep a close eye on the annual expense figure. The tables that begin on page 166 should help you. In addition to performance ratings for bull and bear markets, the tables show a composite expense estimate for each fund. This figure combines the effect of an upfront sales load with five years of total annual expenses, assuming a $1,000 investment. The number is similar to, but a little lower than, the five-year expense projection published at the front of a fund prospectus. ■

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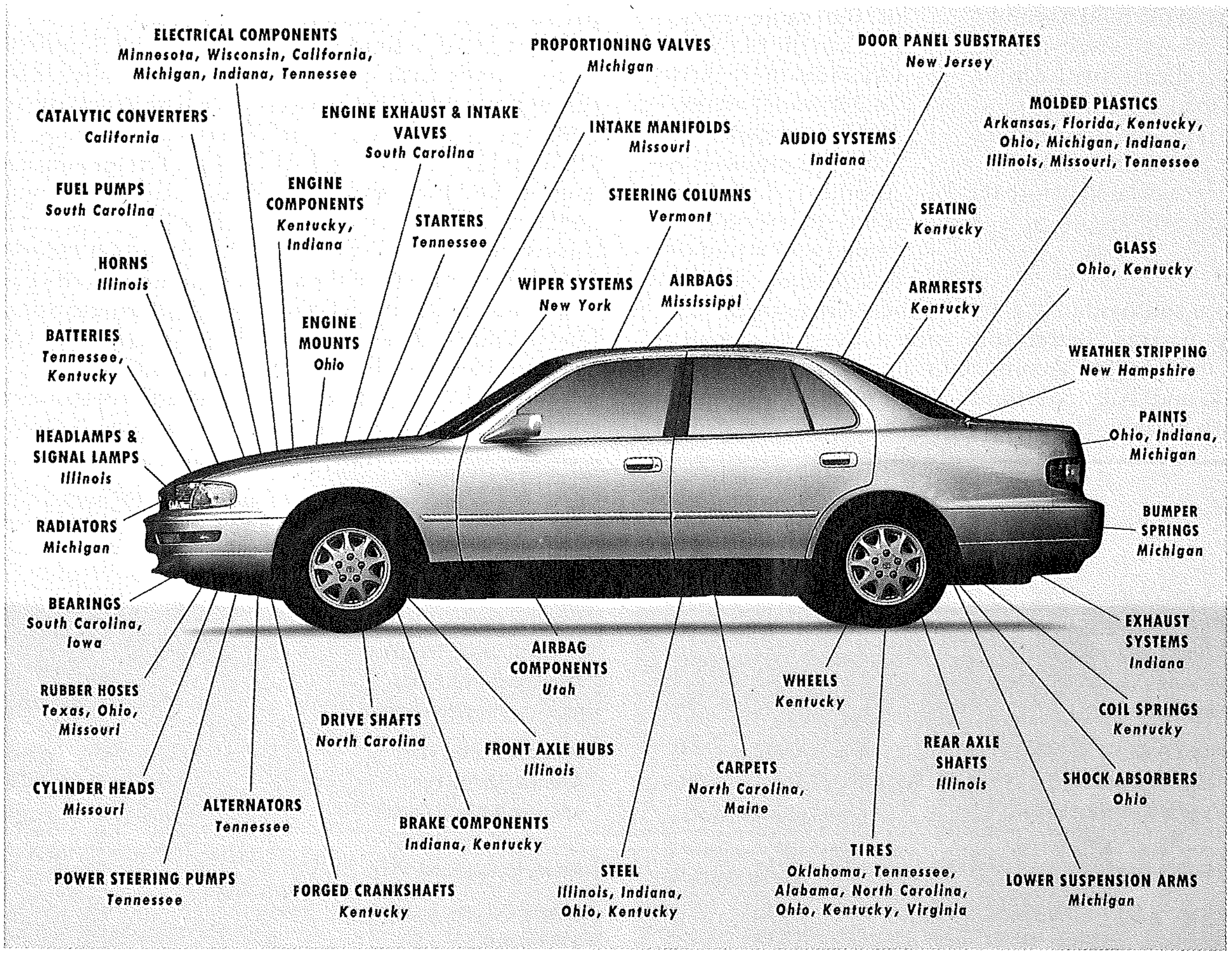

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Explanations

The five-year cumulative expense is the sum of the maximum upfront load plus five years of expenses at recent rates, for a hypothetical $1,000 account experiencing no investment gains. If the fund has multiple classes of shares, data are for the class with a front-end load. Morningstar, Inc. provided these figures. The 12-month total return is calculated before the effect of the sales load.

Stock and balanced funds

The Acorn Fund is one of the more attractive funds in the table below. One reason is Acorn's 24.2% total return in 1992, compared with 7.6% for the S&P 500. Another is Acorn's long-term performance: It earned an A rating for its bull-market performance and has fared as well as the average stock fund in bear markets. Better still, with a five-year cumulative expense of $36, Acorn ranks among the cheapest-run stock and balanced funds. Note the asterisk next to Acorn's name: It indicates that the fund levies neither a front-end or back-end sales load nor a 12b-1 fee for marketing and distribution.

To be listed, a fund must have at least $25 million in assets. Funds earn a FORBES rating only after wading through at least two full market cycles. The last two up-and-down cycles go back to June 1983 for stock funds, April 1983 for balanced funds, July 1984 for foreign funds, and August 1987 for global funds. Funds are rated by comparing their performance with funds of the same type and with market benchmarks. The S&P 500 is the benchmark for stock funds; a blend of the S&P 500 and the Merrill Lynch corporate/government bond index is used to rate balanced funds. A dollar-denominated index of foreign stocks from Morgan Stanley is the benchmark for foreign funds. The benchmark for global funds is a combination of the S&P 500 and the Morgan Stanley index.

Fund	Performance in UP —markets—	Performance in DOWN —markets—	12-month total return	5-year cumulative expense†
ABT Growth & Income Trust	D	D	3.3%	$109
ABT Invest-Emerging Growth	A	D	13.9	127
ABT Utility Income Fund	F	A	10.4	105
Acorn Fund*	A	C	24.2	36
Adams Express*	C	B	9.6	23
Affiliated Fund	C	B	12.3	87
AIM Equity-Charter Fund	B	C	1.1	113
AIM Equity-Constellation Fund	A+	F	15.0	115
AIM Equity-Weingarten Fund	A+	D	–1.4	110
AIM Growth Fund	C	C	0.1	115
AIM Summit Fund	B	D	4.5	123
Alliance Balanced Shares (B)	C	C	6.8	126
Alliance Fund	A	D	14.7	97
Alliance Global-Small Cap	D	D	–4.9	169
Alliance Growth & Income	C	B	4.5	112
Alliance International Fund (F)	B	C	–5.9	146
Alliance Quasar Fund	B	D	2.8	137
Alliance Technology Fund	A	D	15.5	132
Amcap Fund	C	B	7.2	95
American Balanced Fund (B)	B	B	9.4	99
American Capital Comstock	B	A	6.4	99
American Capital Convert Secs* (B)	C	B	12.1	45e
American Capital Emerging Grow	B	A	9.4	115
American Capital Enterprise	B	D	7.9	106
American Capital Equity Income (B)	C	B	10.7	109
American Capital Growth & Inc	D	B	9.4%	$115
American Capital Harbor Fund (B)	C	D	9.6	103
American Capital Pace Fund	C	A	4.2	108
American Growth Fund	F	A	12.6	158
American Investors Growth	F	F	–12.4	127
American Leaders Fund	D	A	11.6	96
American Mutual Fund	D	A	7.7	89
American National Growth	C	C	–2.4	112
American National Income	D	A+	3.3	122
Amway Mutual Fund	C	C	1.4	85e
Analytic Optioned Equity Fund*	F	A	6.2	60
ASA Limited* (F)	D	D	–27.3	33e
Babson Growth Fund*	C	D	9.1	43
Baker, Fentress & Co*	F	C	5.4	40
Bancroft Convertible Fund* (B)	F	D	15.5	60
Bartlett Capital-Basic Value*	D	A	10.2	60
Berger One Hundred	A+	D	8.5	112
Berger One Hundred and One	C	B	4.8	133
Bergstrom Capital*	A+	A	1.1	44e
Wm Blair-Growth*	B	C	7.6	43
Blanchard Global Growth (G)	C	A	0.7	116
Boston Co Capital Appreciation	D	C	4.0	61
Bull & Bear Gold Investors (G)	D	C	–17.2	148
Bull & Bear Special Equities	F	D	16.0	150
Burnham Fund	D	B	7.6	110

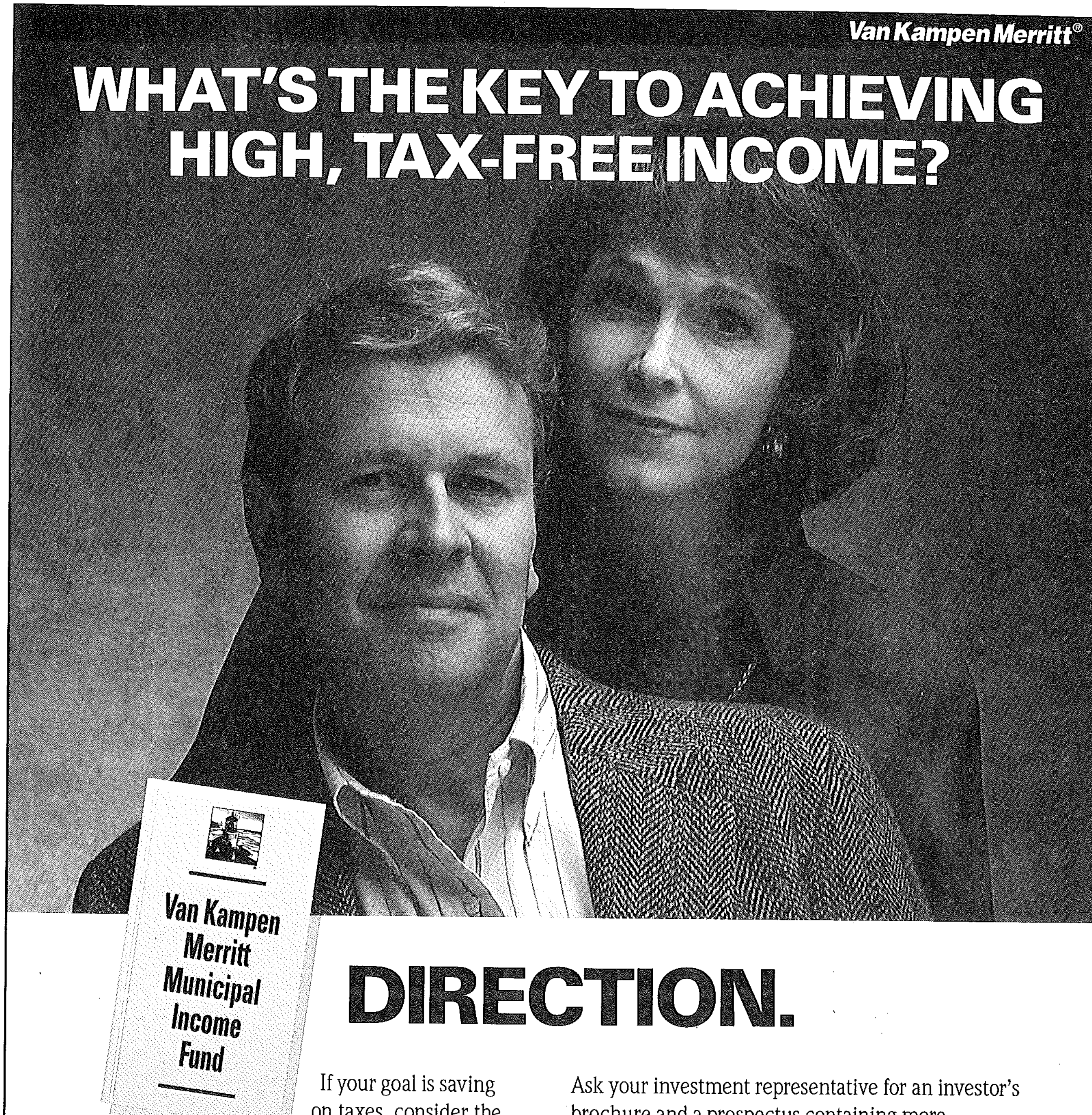
*Fund has no load or shareholder-paid 12b-1 plan. † See box above for explanation. e: Estimate. (B): Balanced. (F): Foreign. (G): Global.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
Calvert Social Inv–Managed Grow (B)	C	D	7.4%	$112
Capstone US Trend	C	D	0.7	99
Cardinal Fund	C	B	9.8	119
Castle Convertible Fund* (B)	D	A	16.6	55
Central Securities*	C	D	26.9	40
Century Shares Trust*	A	A	27.0	48
CGM Capital Development*	A+	B	17.5	43
CGM Mutual Fund* (B)	A+	D	6.0	47
Clemente Global Growth Fund* (G)	B	C	–3.1	136
Colonial Fund (B)	A	D	12.3	110
Colonial Growth Shares Trust	B	D	11.0	115
Colonial Natural Resources (G)	F	F	–7.3	159e
Colonial Strategic Income (B)	D	D	9.8	106
Colonial Utilities Fund (B)	D	B	21.0	93
Columbia Growth Fund*	B	C	11.8	43
Composite Bond & Stock Fund (B)	D	B	9.9	99
Composite Growth Fund	D	A	11.0	100
Copley Fund*	D	A	17.7	69
Dean Witter American Value	B	C	3.8	89
Dean Witter Developing Growth	D	D	–2.5	93
Dean Witter Dividend Growth	C	A	5.8	71
Dean Witter Natural Resource Dev	F	C	6.7	97
Dean Witter World Wide Inv (G)	C	C	–7.5	114
Delaware Group Decatur I	D	A	8.8	121
Delaware Group Trend Fund	A+	C	22.4	117
Dodge & Cox Balanced Fund* (B)	B	C	10.6	33
Dodge & Cox Stock Fund*	B	B	10.8	32
Dreyfus Capital Growth	D	C	6.2	87
Dreyfus Convertible Securities* (B)	D	C	3.8	54
Dreyfus Fund*	D	B	5.5	39
Dreyfus Growth Opportunity Fund*	C	D	–4.2	48
Dreyfus Strategic World Inv (G)	C	A	–2.7	111
Dreyfus Third Century Fund*	C	D	1.9	54
Eaton Vance Growth Fund	B	B	5.4	91
Eaton Vance Investors Fund (B)	C	C	6.4	91
Eaton Vance Special Equities	B	B	2.6	97
Eaton Vance Stock Fund	C	B	7.0	94
Eaton Vance Total Return Trust	D	A	6.6	123
Enterprise Group–Growth	B	B	6.5	128
Equity Strategies Fund*	C	C	2.7	56
EuroPacific Growth Fund (F)	C	C	2.3	120
Evergreen Fund*	C	C	8.7	57
Evergreen Limited Market Fund*	A	A	9.9	63
Evergreen Total Return Fund*	D	A	9.9%	$61
FBL–Growth Common Stock	F	C	10.1	85
Federated Stock & Bond Fund* (B)	D	A	7.3	52
Federated Stock Trust*	D	A	11.9	50
Fidelity Advisor Equity–Income	C	B	14.7	81e
Fidelity Contrafund	A+	C	15.8	73
Fidelity Destiny Portfolio I*	A	B	15.1	113
Fidelity Equity-Income	D	A	14.6	54
Fidelity Fund*	C	B	8.4	34
Fidelity Growth Company	A	D	7.9	85
Fidelity Magellan Fund	A+	A	6.8	83
Fidelity Puritan Fund (B)	A	B	15.4	52
Fidelity Retirement Growth*	B	C	10.4	53
Fidelity Select–American Gold (G)	D	A	–3.1	118
Fidelity Select–Energy	F	C	–2.4	119
Fidelity Select–Financial Services	A	B	42.3	123
Fidelity Select–Health Care	A+	D	–17.4	102
Fidelity Select–Prec Metals & Mins (F)	D	D	–21.9	121
Fidelity Select–Technology	B	F	9.4	116
Fidelity Select–Utilities	C	A	10.4	106
Fidelity Trend Fund*	A	D	16.7	25
Fidelity Value Fund*	B	B	21.1	50
Fiduciary Capital Growth*	D	C	14.4	70
Financial Dynamics Fund	A	D	13.2	59
Financial Industrial Fund	B	C	2.9	52
Financial Industrial Income	B	B	1.0	49
Financial Strategic–Pacific Basin* (F)	A	C	–13.6	94
First Investors Global Fund (G)	C	D	–4.8	161
Flex-funds–Growth Fund	F	A	6.4	75
Fortis Capital Fund	B	B	6.5	109
Fortis Fiduciary Fund	A	C	6.8	121
Fortis Growth Fund	A	C	0.9	104
Founders Blue Chip Fund	C	C	–0.5	62
Founders Growth Fund	B	C	4.3	78
Founders Special Fund*	A	D	8.2	64
FPA Capital Fund	A	C	21.0	119
FPA Paramount Fund	B	A	9.5	111
Franklin DynaTech Fund	C	D	4.2	80
Franklin Equity Fund	C	D	3.6	75
Franklin Gold Fund (F)	C	D	–20.3	56
Franklin Growth Fund	C	B	2.9	72
Franklin Income Fund (B)	C	B	14.9	67
Franklin Utilities Fund	D	A+	9.0	68

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate. (B): Balanced. (F): Foreign. (G): Global.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

Fund	Performance in UP markets	Performance in DOWN markets	12-month total return	5-year cumulative expense†
Fundamental Investors	B	B	10.1%	$92
Gateway Index Plus Fund*	D	A	5.2	57
General American Investors*	A+	C	3.7	51e
General Securities	D	B	6.0	120e
George Putnam Fund of Boston (B)	B	C	7.9	111
Gintel Erisa Fund	D	A	14.4	75
Gintel Fund*	C	B	24.6	70
Growth Fund of America	B	B	7.4	97
GT Global Growth–Pacific (F)	B	B	–8.0	148
GT Global Growth–Worldwide (G)	A	C	3.3	153
Guardian Park Avenue Fund	A	B	20.4	79
Hancock Freedom Global (G)	B	D	–0.3	137e
Hancock Freedom Global Tech	D	C	5.4	158
Hancock Freedom Natl Av & Tech	D	D	2.8	131
Hancock Growth Fund	B	D	6.0	129
Hancock Sovereign Inv	C	A	7.2	108
Hartwell Emerging Growth	A+	F	1.0	126
IAA Trust Growth	D	C	2.1	73e
IAI Regional Fund	A	B	3.5	63
IAI Stock Fund	D	B	3.9	63
IDS Discovery Fund	A	D	8.6	102
IDS Equity Plus Fund	B	C	10.5	87
IDS Growth Fund	A	D	8.1	94
IDS Mutual Fund (B)	B	C	10.4	88
IDS New Dimensions Fund	A	C	5.3	97
IDS Progressive Fund	D	B	20.2	101
IDS Stock Fund	C	B	6.8	86
Income Fund of America (B)	B	A+	12.0	91
Investment Co of America	B	B	7.0	87
Investors Research Fund	D	D	–9.7	113
Ivy Growth Fund	C	A	5.2	123
Janus Fund*	A	A	6.9	48
Japan Fund* (F)	B	C	–16.7	73
JP Growth Fund	C	B	5.6	99
Kemper Growth Fund	A	D	–1.6	110
Kemper International Fund (F)	C	B	–4.8	128
Kemper Small Cap Equity	A	D	0.0	121
Kemper Technology Fund	C	D	–1.3	98
Kemper Total Return Fund (B)	A+	D	2.5	109
Keystone America Omega	A	F	3.8	125
Keystone Custodian K-1 (B)	C	C	3.4	99
Keystone Custodian K-2	B	D	8.2	81
Keystone Custodian S-1	D	C	0.0	104
Keystone Custodian S-3	B	D	5.0%	$85
Keystone Custodian S-4	A	F	8.9	74
Keystone International Fund (F)	C	C	2.4	172
Keystone Precious Metals (F)	D	D	–13.6	135
Kleinwort Benson Intl Equity* (F)	C	C	–3.4	94
Legg Mason Value Trust	C	B	11.4	95
Lexington Corp Leaders Trust*	B	B	9.6	32
Lexington Global Fund* (G)	B	C	–3.5	77
Lexington Goldfund (G)	D	B	–20.5	78
Lexington Growth & Income	D	C	12.4	55
Lexington Worldwide Emerg Mkts* (F)	C	A	3.8	94
Lindner Fund*	D	A+	12.8	40
Lord Abbett Developing Growth	D	D	–3.1	115
Lord Abbett Value Appreciation	B	C	13.6	115
Lutheran Brotherhood Fund	C	A	5.8	100
Mairs & Power Growth Fund*	B	C	4.4	55e
Horace Mann Growth Fund*	C	D	9.7	38e
Mass Investors Growth Stock	B	C	6.4	90
Mass Investors Trust	B	C	7.5	88
Mathers Fund*	D	C	3.1	47
Merrill Lynch Basic Value	D	B	10.4	94
Merrill Lynch Capital Fund	C	A	4.9	92
Merrill Lynch Healthcare (G)	C	C	3.7	143
Merrill Lynch Intl Holdings (G)	C	B	4.1	140
Merrill Lynch Pacific Fund (F)	A	B	–8.4	116
Merrill Lynch Phoenix Fund (B)	B	C	26.5	135
Merrill Lynch Special Value	F	D	17.0	143
Merrill Lynch Technology (G)	D	D	21.7	65
Mexico Fund* (F)	A	A+	12.1	56
MFS Capital Development Fund	C	C	7.7	102
MFS Emerging Growth Fund	A	D	7.3	129
MFS Lifetime Worldwide Equity (G)	C	B	1.6	143
MFS Research Fund	B	D	11.0	100
MFS Special Fund	B	C	17.9	134
MFS Total Return Fund (B)	A	C	10.1	90
MSB Fund*	D	C	10.7	93
Mutual Benefit Fund	B	B	10.5	90
Mutual of Omaha Growth	A	C	1.2	109
Mutual of Omaha Income (B)	D	A	7.6	100
Mutual Series–Beacon*	C	C	22.8	43
Mutual Series–Mutual Shares*	C	A+	21.3	41
Mutual Series–Qualified*	C	A+	22.6	42
National Income & Growth (B)	B	B	11.9	127

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate. (B): Balanced. (F): Foreign. (G): Global.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.



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STOCK AND BALANCED FUNDS

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
National Industries Fund*	D	D	–0.5%	$75
National Stock Fund	C	B	16.8	126
National Total Return Fund (B)	B	C	9.7	125
Nationwide Fund	B	B	3.0	105
Nationwide Growth Fund	C	B	6.3	108
N & B Guardian Fund*	A	C	19.0	42
N & B Manhattan Fund*	A	C	17.8	55
N & B Partners Fund*	C	A	17.5	43
N & B Selected Sectors*	B	D	21.1	47
New Perspective Fund (G)	B	A	4.0	101
New York Venture Fund	A	C	12.1	93
Nicholas Fund*	B	A	12.6	39
Northeast Investors Growth*	B	C	–0.8	73
Oppenheimer Equity Income	D	B	7.1	99
Oppenheimer Fund	D	F	8.3	112
Oppenheimer Global Fund (G)	A	B	–14.2	125
Oppenheimer Gold & Spec Mins (G)	C	C	–10.1	127
Oppenheimer Special Fund	B	C	13.3	103
Oppenheimer Target Fund	C	D	10.3	110
Oppenheimer Time Fund	B	D	1.6	106
Oppenheimer Total Return	B	D	12.7	104
PaineWebber Atlas Global Growth (G)	B	C	–8.5	127
Pax World Fund (B)	C	C	0.6	55
Penn Square Mutual Fund	D	B	8.7	95
Pennsylvania Mutual Fund	C	B	16.2	46
Permanent Port–Permanent (B)	D	C	2.5	64
Petroleum & Resources Corp*	D	D	5.8	29
Philadelphia Fund	D	C	19.7	91
Phoenix Balanced Fund (B)	A	D	6.7	99
Phoenix Convertible Fund (B)	C	B	12.9	111
Phoenix Growth Fund	B	A	4.3	108
Phoenix Stock Fund	C	B	7.6	113
Phoenix Total Return	D	B	10.3	126
Pilgrim MagnaCap Fund	C	C	8.0	110
Pioneer Fund	C	D	13.6	101
Pioneer II Fund	C	B	9.2	100
Pioneer Three Fund	B	B	19.9	95
T Rowe Price Balanced* (B)	B	D	2.0	50
T Rowe Price Growth & Income*	C	B	15.3	45
T Rowe Price Growth Stock Fund*	C	D	6.0	43
T Rowe Price Intl Stock* (F)	B	B	–3.5	55
T Rowe Price New Era Fund*	D	D	2.1	42
T Rowe Price New Horizons Fund*	B	D	10.3	48

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
T Rowe Price OTC	D	B	13.2%	$67
Princor Capital Accumulation	D	A	8.9	96
Princor Growth Fund	A	D	10.1	104
ProvidentMutual Growth	C	B	1.7	139
ProvidentMutual Investment Shrs	F	B	2.2	135
ProvidentMutual Total Return (B)	D	C	12.9	136
Prudential Equity Fund	B	B	13.6	98
Prudential Global Fund (G)	C	D	–4.5	135
Prudential Growth Fund	D	C	4.5	123e
Prudential Growth Opportunity	B	D	21.2	121
Prudential Utility Fund	B	A	9.9	97
Putnam Convert Income-Growth (B)	B	D	21.1	115
Putnam Energy-Resources Trust	D	F	6.8	138
Putnam Fund for Growth & Inc	C	B	11.7	105
Putnam Global Growth (G)	A	C	0.2	131
Putnam Health Sciences Trust	A	D	–10.5	118
Putnam Investors Fund	C	D	7.9	105
Putnam OTC Emerging Growth	A	C	12.4	127
Putnam Strategic Income	D	B	4.8	118
Putnam Vista Fund	A	B	17.4	106
Putnam Voyager Fund	A+	D	9.6	118
Quest for Value Fund	C	A+	17.8	141
Rea-Graham Balanced Fund (B)	C	C	4.2	152
Royce Fund–Value	D	B	16.0	116
Safeco Equity Fund*	B	C	9.3	49
Safeco Growth Fund*	C	C	–3.1	47
Safeco Income Fund*	D	A	11.5	47
Salomon Brothers Capital	C	B	4.9	119
Salomon Brothers Fund*	D	B	3.3	22e
Salomon Brothers Investors	C	B	7.3	85
Salomon Brothers Opportunity*	C	B	13.8	65
Scudder Capital Growth*	A	C	7.0	52
Scudder Development Fund*	A	C	–1.9	65
Scudder Global Fund* (G)	A	C	4.5	80
Scudder Growth & Income Fund*	C	C	9.5	48
Scudder International Fund* (F)	C	B	–2.7	65
Security Action Fund	C	C	5.3	124
Security Equity Fund	A	D	10.7	112
Security Investment Fund	F	C	4.8	122
Security Ultra Fund	D	F	7.6	138
Selected American Shares	B	A	5.9	60
Selected Special Shares	C	D	8.3	70
Seligman Capital Fund	A	D	11.5	98

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate. (B): Balanced. (F): Foreign. (G): Global.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

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Fund	Performance in UP markets	Performance in DOWN markets	12-month total return	5-year cumulative expense†
Seligman Common Stock Fund	B	B	10.9%	$84
Seligman Growth Fund	B	D	11.3	86
Seligman Income Fund (B)	D	A	17.5	90
Sentinel Balanced Fund (B)	C	B	6.2	125
Sentinel Common Stock Fund	B	A	5.8	121
Sentinel Growth Fund	B	C	6.0	105
Sentry Fund*	B	D	7.5	42
Sequoia Fund*	C	A+	9.3	50
Shearson Appreciation	B	B	6.2	90
Shearson Fundamental Value	D	B	14.8	114
Shearson Global Oppors (G)	C	D	–6.3	130
Shearson Invest–Special Equities	D	D	9.1	116
Sit New Beginning Growth Fund*	A	C	–2.1	42
Sit New Beginning Income & Growth*	C	B	4.9	75
Smith Barney Equity Fund	D	C	0.7	95
Smith Barney–Income & Growth	D	A+	7.2	94
SoGen International Fund	D	A+	8.5	106
Source Capital Fund*	D	A+	13.2	49
State Bond Common Stock Fund	B	D	0.8	109
State Bond Diversified Fund	C	B	1.5	109
State Street Investment Trust	B	C	6.3	70
SteinRoe Capital Opportunities*	D	F	2.4	54
SteinRoe Special Fund*	A	C	13.9	50
SteinRoe Stock Fund*	B	D	8.2	46
SteinRoe Total Return Fund* (B)	C	F	7.9	42
Stratton Growth Fund*	D	C	6.6	68
Stratton Monthly Dividend Shares*	D	A+	10.3	62
Strong Investment Fund (B)	F	A	3.2	60
Strong Total Return Fund (B)	D	B	0.5	65
Templeton Emerging Markets* (G)	A	A	9.1	96
Templeton Foreign Fund (F)	C	A	0.1	105
Templeton Growth Fund (G)	B	B	4.1	102
Templeton Income Fund (G)	C	A	3.1	94
Templeton Smaller Cos Growth (G)	B	D	3.4	124
Templeton World Fund (G)	C	C	3.1	101
TNE Growth Fund	A	B	–6.7	122
TNE Growth Opportunities	C	D	9.3	118
TNE Retirement Equity Fund	D	A	16.6	123
Thomson–International (G)	B	D	–4.9	138e
Transamerica Capital Apprec	D	C	5.4	132
Transamerica Growth & Income (B)	C	C	6.0	117
Tri-Continental Corp*	C	C	7.0	34
20th Century Growth Investors*	A	D	–4.3	50
20th Century Select Investors*	B	C	–4.4%	$50
20th Century Ultra Investors*	A+	F	1.3	50
UMB Stock Fund*	C	B	7.1	43
United Accumulative Fund	C	B	14.2	117
United Continental Income Fund (B)	A	D	10.4	125
United Income Fund	B	A	12.0	118
United International Growth (F)	C	A	–1.1	144
United New Concepts Fund	B	C	4.5	147
United Retirement Shares (B)	A	C	12.8	126
United Science & Energy Fund	B	C	–4.0	129
United Services–Global Res* (G)	D	C	–2.7	117
United Services–Gold Shares* (F)	D	F	–50.8	77
United Services–World Gold* (G)	D	D	–4.7	110
United Vanguard Fund	D	B	3.4	133
USAA Investment–Cornerstone* (G)	B	B	6.3	60
USAA Mutual–Aggressive Growth*	C	D	–9.3	40
USAA Mutual–Growth Fund*	C	D	9.8	55
Value Line Fund*	B	C	4.5	36
Value Line Income Fund*	D	A	1.7	44
Value Line Leveraged Growth Inv*	B	A	–2.5	45
Value Line Special Situations*	D	D	–3.5	52
Van Eck Gold/Resources Fund (G)	D	B	–4.5	149
Van Eck International Investors (F)	C	D	–29.1	144
Van Eck World Trends Fund (G)	D	B	–8.5	141
Vanguard Explorer Fund*	C	D	13.0	33
Vanguard Index–500 Portfolio*	B	C	7.4	10
Vanguard/Morgan Growth*	B	C	9.5	25
Vanguard Small Cap Stock	C	D	18.1	9
Vanguard Special–Gold & Prec (F)	D	C	–19.4	18
Vanguard Trustees Comm–Intl* (F)	B	C	–8.7	22
Vanguard Trustees Comm–US*	C	B	6.4	29
Vanguard Wellesley Income Fund* (B)	C	A	8.6	19
Vanguard Wellington Fund* (B)	B	C	7.9	19
Vanguard Windsor Fund*	C	A	16.3	14
Vanguard World–Intl Growth* (G)	C	C	–5.8	29
Vanguard World–US Growth* (G)	A	B	2.8	25
Washington Mutual Investors	B	A	9.1	95
Winthrop Focus Funds–Aggressive	A	F	17.6	93
Winthrop Focus Funds–Growth	D	D	1.9	63
Winthrop Focus Funds–Grow & Inc	D	C	5.8	68
Worldwide Value Fund* (G)	D	D	–7.4	110
WPG Growth & Income Fund*	B	C	13.6	66
WPG Tudor Fund*	A	C	5.2	61

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate. (B): Balanced. (F): Foreign. (G): Global.
Sources: CDA/Wiesenberger; Forbes; Morningstar.

THE FUNDS

Taxable bond funds

Most bond funds show sharply lower returns than they did one year earlier. Unlike in 1991—when falling interest rates boosted the value of bond portfolios—interest rates stayed fairly steady in 1992. Last year taxable bond fund returns were driven more by interest payments than by capital appreciation. The best 12-month returns came mostly from funds holding high-yield bonds. The median 12-month return for junk bond funds was 17.1%, versus 6.6% for high-grade bond funds.

To be listed, a bond fund must have $100 million or more in assets and at least 12 months of performance. The five-year expense figure is particularly important for bond funds, since their performance otherwise tends to vary less than that of equity funds. The benchmark for high-grade bonds is the Merrill Lynch corporate/government bond index. We rate junk bond funds with $100 million in assets and at least two full market cycles, comparing them with the Merrill Lynch High Yield Master Index.

Fund	Performance in UP —markets—	Performance in DOWN —markets—	12-month total return	5-year cumulative expense†
AAL Bond Fund	B	C	6.6%	$99
AARP Inc–GNMA & US Treasury*	D	B	6.6	36
AARP Inc–High Quality Bond*	C	C	6.2	55
ACM Government Income Fund*	A	D	9.0	79
ACM Government Opportunity*			5.9	61
ACM Government Securities*			9.6	77
ACM Government Spectrum*			6.5	63
ACM Managed Income Fund*			16.6	55
ACM Managed Multi-Market Tr* (I)			–4.6	149
Advantage Government Securities	C	C	9.8	70
AIM Government Securities	D	A	6.3	98
AIM High Yield Fund (J)	B	A	18.5	107
AIM Income Fund	A	D	7.4	98
AIM Limited Maturity Treasury Shs	F	A	5.9	42
Alliance Bond–High Yield (J)	C	D	16.2	125
Alliance Bond–US Government	C	C	6.0	104
Alliance Mortgage Secs Income	C	B	7.7	108
Alliance Multi-Market Inc & Grow (I)			2.0	145e
Alliance Multi-Market Strategy (I)			–2.5	163
Alliance Short-Term Multi-Market (I)			0.3	86
Alliance World Income (I)			1.7	83
Allstate Prime Income Trust			5.8	76e
American Adj Rate Term–1995*			5.2	36
American Adj Rate Term–1996*			5.3	31
American Capital Bond Fund*	C	D	9.3	36
American Capital Corp Bond	C	B	8.5	98
American Capital Federal Mort	D	B	3.1	98
American Capital Govt Secs	B	D	6.5	96
American Capital High Yld Inv (J)	C	D	17.3	101
American Capital Income Trust*			13.6	52e
American Government Income*			15.1	104
American Government Inc Port*			16.3	112
American High-Income Trust (J)			14.3	98
American Opportunity Income*			16.0	58
AMEV Securities*	D	A	9.1	41
Babson Bond–Portfolio L*	B	C	7.9	49
Bartlett Capital–Fixed Income*	C	C	6.9%	$50
Benham GNMA Income*	B	B	7.7	31
Benham Target Maturities–2000*	A+	F	8.5	34
Benham Target Maturities–2005*	A+	F	9.6	34
Benham Target Maturities–2015*	A+	F	7.8	32
Benham Treasury Note Fund*	C	C	6.5	30
Bernstein Govt Short Duration*			5.4	33
Bernstein Intermed Duration*			7.7	32
Bernstein Short Duration +*			6.4	33
Blackrock Advantage Term Trust*			3.6	59
Blackrock Income Trust*			1.4	52
Blackrock Target Term Trust*			6.1	47
Wm Blair–Income*			7.2	46
Blanchard Short-Term Global Inc (I)			3.5	66
Bond Fund of America	C	B	11.4	86
Capital World Bond Fund (I)			0.8	119
Capstone Govt Income	F	A	3.6	55
Cardinal Government Obligations	D	A	6.4	82
Cigna High Income Shares* (J)			21.6	159
Colonial Federal Securities	A	D	6.2	111
Colonial High Yield Securities (J)	B	C	21.2	114
Colonial Income Fund	C	B	8.9	110
Colonial InterMarket Income I*			10.4	52
Colonial US Government	D	A	5.0	106
Columbia Fixed Income Secs*	A	D	8.0	33
Common Sense–Government	B	D	6.8	116
Composite US Govt Securities	C	C	6.1	90
Comstock Partners Strategy Fund			–2.5	101
Dean Witter Federal Secs	B	D	6.5	75
Dean Witter Global S-T Income (I)			2.2	77e
Dean Witter Government Income*			5.8	36
Dean Witter High Yield Secs (J)	A	F	24.2	94
Dean Witter Intermediate Income			6.3	84
Dean Witter Premier Income			4.1	87e
Dean Witter US Govt Securities	D	A	5.8	61
Dean Witter World Wide Income (I)			3.1	94

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate. (I): International. (J): Junk.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
Delaware Group Delchester (J)	B	C	17.2%	$102
Delaware Group Treas Res Intermed	D	A	5.6	74
Delaware Group US Govt	C	B	6.4	106
Dodge & Cox Income Fund*			7.8	32
Dreyfus A Bonds Plus*	A	D	8.2	44
Dreyfus GNMA Fund	C	C	6.3	48
Dreyfus 100% US Treas Intermed*	B	D	7.2	25
Dreyfus 100% US Treasury L-T*	A+	F	7.6	28
Dreyfus Premier GNMA	B	B	6.5	82
Dreyfus Short-Intermediate Govt*	D	A	7.0	17
Dreyfus Strategic Governments Inc*			5.0	44
Eaton Vance Government Oblig	D	B	5.3	122
Eaton Vance High Income Trust (J)	B	C	17.8	110
Eaton Vance Prime Rate Res			6.2	69e
Eaton Vance Short-Term Global (I)			−0.8	100
Eaton Vance Short-Term Treas			3.2	30e
Federated High Yield Trust* (J)	A	C	15.0	38
Fidelity Advisor Limited Term	C	B	7.2	76e
Fidelity Advisor Sh-Intermed Govt	D	A	7.2	70e
Fidelity Capital & Income* (J)	B	B	28.0	40
Fidelity Ginnie Mae*	C	B	6.7	40
Fidelity Global Bond Fund* (I)			4.4	65
Fidelity Government Securities*	B	C	7.9	35
Fidelity Intermediate Bond Fund*	D	B	6.1	32
Fidelity Inv Grade Bond*	B	C	8.3	35
Fidelity Mortgage Securities*	C	B	5.6	40
Fidelity Short-Term Bond*	D	A+	7.4	43
Financial Bond Shs–High Yield (J)	D	A	14.6	53
Financial Bond Shs–Select Inc	D	A	10.4	58
First Australia Prime Income* (I)			−3.3	73
First Boston Income Fund*	D	A	12.2	40
First Investors Fund for Income (J)	D	D	16.7	122
First Investors Government Fund	B	D	5.9	137
First Investors High Yield Fund (J)	C	D	18.9	140
Flag Inv Total Return US Treas			5.1	84
Fort Dearborn Income Securities*	A	D	8.7	41e
Fortis Advantage–Govt Total Ret	D	C	4.8	108
Fortis US Govt Securities Fund	C	C	5.6	81
Franklin Adj US Govt Securities	F	A+	4.0	49
Franklin AGE High Income Fund (J)	C	D	16.5	69
Franklin Global Opportunity Inc (I)			−0.2	65
Franklin Principal Maturity Trust*			8.0	161
Franklin Short-Intermed US Govt	D	B	6.6	51
Franklin Tax-Advantaged US Govt	C	B	7.2	77
Franklin US Government Securities	D	A	7.3	66
Franklin Universal Trust* (J)			20.7	173

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
Fund for US Govt Securities	D	B	5.3%	$91
Global Government Plus* (I)			−0.3	58
Global Income Plus Fund* (I)			1.8	57
Global Yield Fund* (I)			−1.0	51
GNA Investors–US Govt Secs	C	B	5.8	86
Government Income Securities	D	B	6.1	56
Gradison-McDonald Govt Inc			7.4	68
GT Invest–Global Govt Inc (I)			1.9	115
Hancock Freedom Global Inc (I)			−2.3	113e
Hancock Freedom S-T World (I)			3.4	101e
Hancock Income Securities*	B	B	9.2	41
Hancock Investors Trust*	B	B	9.0	41
Hancock Sovereign Bond	C	B	8.0	117
Hancock Sovereign Freedom Govt	B	D	4.5	78e
Hancock Strategic–Income (J)	D	B	7.5	130
Hancock US Govt Securities	D	B	4.2	121
High Income Advantage Trust* (J)			15.4	50
High Income Advantage Trust II* (J)			16.8	49
Hyperion Total Return Fund*			6.4	109
IAI Bond Fund	A+	D	6.8	55
IAI Reserve Fund	F	A+	3.3	43
IDS Bond Fund	A	C	10.6	86
IDS Extra Income Fund (J)	C	C	19.6	92
IDS Federal Income Fund	D	A	6.4	90
IDS Selective Fund	B	C	9.0	87
IDS Strategy–Income	A	D	9.6	85
InterCapital Income Securities*	D	A	11.0	35
Intermediate Bond Fund of Amer			6.3	93
ISI Total Return US Treasury			4.4	85
Janus Flexible Income Fund*			11.8	50
Kemper Adjustable Rate US Govt	C	C	6.1	55
Kemper Diversified Income Fund (J)	C	B	17.8	106
Kemper High Income Trust* (J)			18.8	111e
Kemper High Yield Fund (J)	A	C	17.0	88
Kemper Inc & Cap Preservation	C	B	7.9	86
Kemper Intermediate Government*			5.4	47e
Kemper Invest–Diversified Income	B	A	16.7	105
Kemper Invest–Government	B	D	4.5	93
Kemper Invest–High Yield (J)	B	C	16.1	95
Kemper Invest–Short-Intermed Govt			5.3	95
Kemper Invest–Short-Term Global (I)			−9.0	92
Kemper Multi-Market Income*			17.2	50e
Kemper Short-Term Global Income (I)			−8.5	85
Kemper US Government Secs	B	C	4.6	77
Keystone America Cap Pres & Inc I			3.4	72
Keystone America Cap Pres & Inc II*			2.3	57

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate. (I): International. (J): Junk.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
Keystone Custodian B-1	C	D	3.8%	$100
Keystone Custodian B-2	D	C	9.7	100
Keystone Custodian B-4 (J)	D	D	17.9	109
Legg Mason Inc-US Govt Intermed			6.3	43
Lexington GNMA Income Fund*	A	D	5.2	51
Liberty Financial US Govt Secs	D	C	6.0	88e
Liberty High Income Bond (J)	A	B	17.1	96
Lord Abbett Bond-Debenture (J)	D	A	15.9	90
Lord Abbett Global-Income (I)			5.8	113
Lord Abbett US Govt Secs	A	D	7.1	95
Lutheran Brotherhood High Yield (J)			20.0	108
Lutheran Brotherhood Income	B	C	8.0	99
Mackenzie Fixed Income Trust	A	D	8.1	123
MainStay-Government Plus	C	D	3.8	90
MainStay-High Yield Corp Bond (J)	B	B	21.4	95
MassMutual Corporate Investors*	F	A+	17.6	72e
Merrill Lynch Corp-High Income (J)	C	A	20.7	70
Merrill Lynch Corp-High Quality	B	C	7.5	70
Merrill Lynch Corp-Intermed	C	B	7.3	52
Merrill Lynch Federal Securities	D	B	5.8	80
Merrill Lynch Global Bond Inv & Ret (I)			7.8	84
Merrill Lynch Prime Fund			6.1	68e
Merrill Lynch S-T Global Income (I)			−2.8	80
Merrill Lynch World Income (I)			6.1	83
MetLife-State Street Govt Income	B	D	6.8	53
MetLife-State Street High Income (J)	B	C	20.4	104
MFS Bond Fund	B	B	6.3	93
MFS Charter Income*			7.1	48
MFS Government Income Plus	C	D	6.0	118
MFS Government Markets Income*	C	C	3.3	51
MFS Government Premium Fund			6.0	107
MFS Government Securities	C	C	7.2	110
MFS High Income Fund (J)	C	C	16.9	103
MFS Intermediate Income*			3.2	49
MFS Lifetime Govt Income +	C	D	5.8	98
MFS Lifetime High Income (J)	A	D	15.9	114
MFS Lifetime Intermediate Inc			2.4	111
MFS Multimarket Income Trust*	D	A	5.4	61
MFS Worldwide Governments (I)			1.3	125
Montgomery Street Income Secs*	B	A	9.7	38
National Bond Fund (J)	B	D	25.0	105
National Federal Securities	A	D	8.0	93
National Multi-Sector Fixed Inc			12.1	123
N & B Limited Maturity*	D	A	5.2	33
New America High Income Fund*			29.7	256
Nicholas Income Fund*	D	A+	10.3	33
Northeast Investors Trust*	F	A+	17.4%	$83
Oppenheimer Champion High Yld (J)			16.3	121
Oppenheimer GNMA Fund	D	B	4.5	114
Oppenheimer Govt Securities	B	C	4.4	94
Oppenheimer High Yield Fund (J)	F	A	13.8	94
Oppenheimer Multi-Sector Income*			7.9	55
Oppenheimer Strategic Income			7.5	107
Oppenheimer US Government	D	C	5.0	106
Overland Express Variable Rate Govt			4.2	67
Pacific American Income Shares*	C	B	7.7	42
Pacific Horizon-US Government			7.6	64
Pacifica Asset Preservation Fund			4.8	39
Pacifica Government Income			5.5	85
PaineWebber Global Income (I)			1.2	108e
PaineWebber High Income (J)	A+	C	24.1	88
PaineWebber Income Fund	A	D	10.9	96e
PaineWebber Inv Grade Income	B	C	8.9	91
PaineWebber S-T Global Inc (I)			3.2	87
PaineWebber US Govt Income	B	C	6.2	87
Parkstone Bond			6.2	84
Parkstone Intermediate Govt Oblig			5.3	84
Parkstone Limited Maturity			5.8	72
Permanent Port-Treasury Bill	F	A+	2.9	37
Phoenix High Yield Fund (J)	D	A	17.0	107
Pilgrim Adj US Govt Secs III			7.1	64e
Pilgrim Prime Rate Trust			6.5	72
Pilgrim S-T Multi-Market Income (I)	F	C	−15.0	115
Pioneer Bond Fund	C	B	7.9	100
Piper Jaffray Govt Income	B	D	4.4	102
Piper Jaffray Inst Govt Income			12.3	49
Portico-Bond IMMDEX Fund			7.6	25
Preferred Income*			24.7	85
T Rowe Price GNMA Fund*	C	B	6.5	43
T Rowe Price High Yield Fund* (J)	D	B	14.8	119
T Rowe Price Intl Bond* (I)			2.9	55
T Rowe Price New Income Fund*	C	C	5.0	44
T Rowe Price Short-Term Bond*	D	A	5.0	44
T Rowe Price Spectrum-Income*			7.8	48e
T Rowe Price US Treasury Intermed*			6.3	40
Princor Government Securities Inc	A	D	6.1	95
Prudential GNMA Fund	C	D	6.2	96
Prudential Government Plus	B	D	6.7	88
Prudential Govt Secs-Intermed	D	C	6.0	40
Prudential High Yield Fund (J)	C	C	16.0	86
Prudential Intermed Global Inc (I)			3.5	112
Prudential S-T Global-Inc (I)			−0.3	81

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate. (I): International. (J): Junk.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
Prudential S-T Global–Assets (I)			1.2%	$74e
Prudential Structured Maturity			7.0	51
Prudential US Government	A	F	6.3	97e
Putnam Adjustable Rate US Govt			3.9	97
Putnam American Government	C	D	6.0	96e
Putnam Diversified Income Trust			12.2	121
Putnam Federal Income	B	D	6.0	106
Putnam Global Governmental Inc (I)			4.5	122
Putnam High Inc Convert & Bond*			27.3	57
Putnam High Yield Advantage (J)	A	B	18.5	114
Putnam High Yield Trust (J)	C	B	19.5	96
Putnam Income Fund	B	B	9.8	93
Putnam Intermediate Govt Income*			7.0	51e
Putnam Master Income Trust*	B	A	12.3	54e
Putnam Master Intermediate Inc*			12.1	49
Putnam Premier Income Trust*			11.8	44
Putnam US Govt Income	D	B	6.6	98
Quest for Value–US Govt Income			6.0	105
RAC Income Fund*			5.0	113
Ranieri Adj Rate US Govt I			−0.1	65
Scudder GNMA Fund*	C	C	7.0	50
Scudder Income Fund*	B	C	6.7	49
Scudder International Bond* (I)			7.6	63
Scudder Short-Term Bond Fund*	D	B	5.4	39
Scudder Short-Term Global Inc* (I)			5.6	50
Shearson Income–Divers Strategy			6.1	81
Shearson Income–High Income (J)	C	C	19.6	83
Shearson Invest–Govt Secs	A	D	5.4	72
Shearson Invest–Inv Grade Bond	A+	F	8.5	78
Shearson Managed Governments	C	C	6.1	91
Shearson S-T World Income (I)			−2.2	93
Shearson World Wide Prime Assets (I)			−1.7	90
Sierra–Corporate Income			9.7	95e
Sierra–US Govt Securities			6.4	85e
Smith Barney–S-T US Treasury			5.9	45e
Smith Barney–US Government	A	C	6.8	66
Spartan Ginnie Mae*			6.5	9
Spartan Government Income*			7.1	33
Spartan High Income* (J)			21.4	35
Spartan Limited Maturity Govt*			5.8	31
SteinRoe Income Fund*	C	B	9.1	45
SteinRoe Intermediate Bond*	B	C	7.7	35
Strong Advantage Fund*			8.6	50
Strong Short-Term Bond Fund*	D	A	6.8	25

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
SunAmerica Equity–US Govt Secs	F	A+	5.3%	$96
SunAmerica Federal Securities	C	C	4.7	95
Templeton Global Govt Income* (I)			−0.6	54
Templeton Global Income Fund* (I)			1.6	41
TNE Bond Income Fund	B	C	7.5	100
TNE Government Securities	A	F	6.8	106
TNE Premium Income			5.6	89
Thomson–Income	D	C	8.3	98
Thomson–US Government	C	D	3.6	98
Transamerica Govt Securities	A	D	6.1	124
Transamerica Income Shares*	A	B	7.4	34
Transamerica Inv Quality Bond	B	D	6.0	133
Transamerica Spec Govt Income			5.3	100
20th Century Long-Term Bond*	A	D	5.5	49
20th Century US Governments*	D	B	4.4	50
United Bond Fund	B	C	7.5	118
United Government Securities	B	D	7.1	82
United High Income Fund (J)	C	D	16.5	125
United High Income Fund II (J)	D	B	15.5	127
US Government Securities	C	B	7.6	92
USAA Investment–GNMA*			6.1	19
USAA Mutual–Income Fund*	A	C	8.3	22
UST Master Funds–Mngd Income	A	D	5.8	98
Value Line US Government Secs*	C	B	6.3	32
Van Eck World Income Fund (I)			−3.5	117
Van Kampen High Yield (J)	C	C	17.0	120
Van Kampen Intermed High Income*			21.3	95
Van Kampen Ltd High Income*			16.9	95
Van Kampen Prime Rate*			6.1	82e
Van Kampen US Government	B	C	6.3	85
Vanguard Bond Market Fund*	B	C	7.1	10
Vanguard Fixed Inc–GNMA*	B	C	6.8	15
Vanguard Fixed Inc–High Yld* (J)	D	A	14.3	17
Vanguard Fixed Inc–I-T US Treas*			7.8	13
Vanguard Fixed Inc–Invest Grade*	A+	D	9.8	16
Vanguard Fixed Inc–L-T US Treas*	A+	F	7.4	13
Vanguard Fixed Inc–Short-Term*	D	A	7.3	13
Vanguard Fixed Inc–S-T Federal*	D	A	6.2	13
Vanguard Fixed Inc–S-T US Treas*			6.7	13
Vanguard Preferred Stock Fund*	A	C	8.4	28
Warburg, Pincus Intermed Mat Govt*			6.7	30
WPG Government Securities Fund*	C	B	7.9	38
Zenix Income Fund*			19.1	177
Zweig Total Return*			2.7	57

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

Municipal bond funds

All municipal bond funds are not alike. Some take on more risk by focusing on high-yield tax-free bonds. Others seek safety by heavily weighting their portfolios with insured securities. Single-state tax-exempt funds help shareholders avoid both federal and state income taxes. But they carry slightly higher risk because their portfolios are tied to the financial health of just one state.

To be listed in this table, a tax-exempt fund must have at least 12 months of performance and $100 million in assets. Funds with at least five years of market history are rated. Each of the 72 months from January 1987 through December 1992 is taken as a bull or bear month, according to the performance of the Lehman Brothers municipal bond index. Composite bull- and bear-market performance is calculated for each fund and these returns are then translated into a letter grade, assigned on a curve.

Fund	Performance in UP —markets—	Performance in DOWN —markets—	12-month total return	5-year cumulative expense†
AAL Municipal Bond Fund			8.3%	$95
AARP Insured T-F Inc-Genl Bond*	A+	D	8.5	37
ABT Southern Master-Fla T-F			9.1	68
AIM Municipal Bond Fund	A	F	9.0	95
Alliance Muni Income-Calif	C	A	9.4	69
Alliance Muni Income-Ins Natl	B	C	9.2	82
Alliance Muni Income-Natl	B	B	10.4	84
Alliance Muni Income-New York	C	B	10.7	79
Allstate Municipal Income*	C	B	8.2	37
Allstate Municipal Income II*			8.2	44
Allstate Municipal Inc Oppor*			2.4	54
Allstate Municipal Inc Oppor II*			3.2	55
Allstate Municipal Inc Oppor III*			5.9	58
Allstate Municipal Premium Inc*			11.5	72
American Capital Muni Bond	A	D	8.8	92
American Capital T-E Hi Yld	D	A+	9.0	101
American Municipal Term Trust*			12.6	30
Benham Calif Tax-Free-Insured*	A	D	9.2	28
Benham Calif Tax-Free-Intermed*	D	A	7.1	26
Benham Calif Tax-Free-L-T*	B	D	8.1	26
Bernstein Diversified Muni*			6.5	35
Bernstein New York Muni*			6.9	35
California Tax-Free Income*	C	A	8.3	30
Calvert Tax-Free Reserves-Limited	F	A+	5.0	56
Churchill T-F Fund of Kentucky	C	B	8.5	54
Colonial California Tax-Exempt	D	A	7.8	86
Colonial High Income Municipal*			6.5	48
Colonial Investment Grade Muni*			6.8	43
Colonial Mass Tax-Exempt	B	C	9.5	71
Colonial Municipal Income Trust*	F	A	6.7	43
Colonial Tax-Exempt Fund	D	A	8.3	100
Colonial Tax-Exempt Insured	C	B	7.5	102
Columbia Municipal Bond Fund*	C	C	6.4	29
Composite Tax-Exempt Bond	C	C	9.0	80
Dean Witter Calif Tax-Free Income	C	D	7.8	66
Dean Witter NY Tax-Free Income	C	D	8.7	70

Fund	Performance in UP —markets—	Performance in DOWN —markets—	12-month total return	5-year cumulative expense†
Dean Witter Tax-Exempt Secs	A	D	9.1%	$65
Delaware Group Tax-Free USA	B	C	9.7	88
Delaware Tax-Free Penn	C	B	9.1	84
Dreyfus Calif Tax-Exempt Bond*	D	B	6.6	34
Dreyfus Insured Muni Bond	C	C	7.7	48
Dreyfus Intermediate Muni Bond*	D	A	8.7	35
Dreyfus Massachusetts T-E Bond*	D	B	7.5	42
Dreyfus Municipal Bond*	C	B	8.4	34
Dreyfus Municipal Income*			8.9	43
Dreyfus NJ Municipal Bond	B	D	8.8	37
Dreyfus NY Insured T-E Bond	B	D	8.5	45
Dreyfus NY Tax-Exempt Bond*	D	B	8.9	35
Dreyfus NY T-E Intermed Bond	D	B	9.4	43
Dreyfus Short-Intermediate T-E	F	A+	6.7	36
Dreyfus Strategic Municipal Bond*			13.3	43
Dreyfus Strategic Municipals*	D	A	8.0	44
Dupree-Kentucky Tax-Free Inc*	D	A	7.9	36
Eaton Vance California Munis	D	D	6.1	94
Eaton Vance Florida Tax-Free			8.0	84
Eaton Vance National Munis	C	C	10.0	91
Eaton Vance NJ Tax-Free			7.8	84
Eaton Vance NY Tax-Free			9.2	85
Eaton Vance Penn Tax-Free			7.7	85
Federated Intermediate Municipal*	D	B	7.1	24
Fidelity Advisor High Inc Muni	C	A+	11.1	93e
Fidelity Calif Tax-Free High Yield*	C	B	8.7	30
Fidelity Calif Tax-Free Insured*	B	C	9.2	33
Fidelity Mass Tax-Free High Yield*	D	B	9.3	29
Fidelity Mich Tax-Free High Yield*	B	B	9.5	31
Fidelity Minnesota Tax-Free*	C	B	7.6	34
Fidelity NY Tax-Free High Yield*	C	B	9.0	31
Fidelity NY Tax-Free Insured*	C	C	8.6	31
Fidelity Ohio Tax-Free High Yield*	C	D	8.7	32
Fidelity Tax-Free-Aggressive*	D	A	9.2	33
Fidelity Tax-Free-High Yield*	C	B	8.4	29
Fidelity Tax-Free-Insured*	B	D	7.9	32

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate.

Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
Fidelity Tax-Free–Ltd Term Munis*	D	A	8.1%	$34
Fidelity Tax-Free–Municipal Bond*	B	C	8.9	25
Financial Tax-Free Income Shares	A+	F	8.8	51
First Investors Insured Tax-Exempt	D	B	8.1	126
First Investors NY Insured T-F	C	C	8.8	134
Flagship Tax-Ex–All-American			10.6	70
Flagship Tax-Ex–Conn Double	A	D	8.9	75
Flagship Tax-Ex–Florida Double			8.7	55
Flagship Tax-Ex–Kentucky Triple	A	D	9.3	73
Flagship Tax-Ex–Limited Term	D	A	8.7	49
Flagship Tax-Ex–Michigan Triple	A	D	9.6	83
Flagship Tax-Ex–NC Triple	A	D	8.8	91
Flagship Tax-Ex–Ohio Double	B	C	8.4	90
Flagship Tax-Ex–Tenn Double	A	D	9.1	84
Fortress Municipal Income	D	A	7.9	62
Franklin Alabama Tax-Free Income	C	C	8.6	76
Franklin Arizona Tax-Free Income	B	C	9.8	68
Franklin Calif Insured T-F Income	B	C	8.6	68
Franklin Calif Tax-Free Income	D	A	9.2	65
Franklin Colo Tax-Free Income	B	B	9.8	75
Franklin Conn Tax-Free Income			8.2	76
Franklin Federal Tax-Free Income	C	B	9.5	66
Franklin Florida Tax-Free Income	B	C	8.6	67
Franklin Hi Yld Tax-Free Income	C	A	9.1	67
Franklin Insured Tax-Free Income	B	C	9.2	67
Franklin Mass Insured T-F Income	C	C	8.8	74
Franklin Mich Insured T-F Income	C	C	9.3	70
Franklin Minn Insured T-F Income	C	B	8.4	73
Franklin Missouri Tax Free Income	C	B	8.8	76
Franklin NJ Tax-Free Income			9.0	70
Franklin NY Tax-Free Income	D	A	11.0	66
Franklin NC Tax-Free Income	B	C	9.0	76
Franklin Ohio Insured T-F Income	C	B	8.8	71
Franklin Oregon Tax-Free Income	B	C	8.5	73
Franklin Penn Tax-Free Income	B	B	9.6	70
Franklin PR Tax-Free Income	C	B	8.9	75
Franklin Texas Tax-Free Income			8.4	75
Franklin Virginia Tax-Free Income	B	C	8.8	74
General Calif Municipal Bond			8.0	19
General Municipal Bond	A	C	9.8	1
General NY Municipal Bond	D	B	10.1	28
Hancock Freedom Mngd Tax-Ex	A	D	7.6	71
Hancock Tax-Exempt Income	B	D	8.3	109

Fund	Performance in UP —markets—	DOWN	12-month total return	5-year cumulative expense†
Hawaiian Tax-Free Trust	D	B	7.9%	$75
IDS California Tax-Exempt Fund	C	C	8.3	82
IDS High Yield Tax-Exempt Fund	C	B	8.7	81
IDS Insured Tax-Exempt Fund	B	D	9.0	84
IDS Minnesota Tax-Exempt Fund	D	B	8.5	83
IDS Tax-Exempt Bond Fund	B	F	6.8	82
Kemper California Tax-Free Inc	C	D	7.8	77
Kemper Florida Tax-Free Inc			8.7	58
Kemper Municipal Bond Fund	A	D	8.7	70
Kemper Municipal Income Trust*			11.1	36e
Kemper New York Tax-Free Fund	C	D	8.9	78
Kemper Strategic Municipal Inc*			9.3	39e
Keystone America Tax-Free Inc	D	B	8.6	109
Keystone Tax-Exempt Trust	C	D	7.0	91
Keystone Tax-Free Fund	C	C	7.5	59
Liberty Financial Tax-Free Bond	C	B	8.9	73e
Liberty Muni Securities	B	C	8.4	89
Limited Term Municipal–Natl	F	A+	7.7	80
Lord Abbett Calif Tax-Free Inc	B	C	9.0	81
Lord Abbett Tax-Free Inc–Natl	B	C	8.7	85
Lord Abbett Tax-Free Inc–NJ			9.2	48
Lord Abbett Tax-Free Inc–NY	C	B	8.8	86
Lutheran Brotherhood Muni Bond	B	C	8.9	92
MainStay–Tax-Free Bond	D	C	8.3	65
Merrill Lynch Calif Muni Bond	C	C	6.7	72
Merrill Lynch Florida Muni			8.2	62
Merrill Lynch Muni–High Yield	B	C	9.4	68
Merrill Lynch Muni–Insured	B	D	9.0	62
Merrill Lynch Muni–Ltd Maturity	F	A+	5.6	28
Merrill Lynch Municipal Income	D	C	7.9	64
Merrill Lynch NY Muni Bond	C	C	10.4	74
MetLife-State Street Tax-Exempt	B	D	9.3	105
MFS California Municipal Bond	B	C	8.6	68
MFS High Yield Muni Bond	D	A	8.0	99
MFS Lifetime Municipal Bond	D	B	7.9	101
MFS M-S Muni Bond–Maryland	C	C	6.7	106
MFS M-S Muni Bond–Mass	D	B	7.9	101
MFS M-S Muni Bond–New York			9.4	80
MFS M-S Muni Bond–N Carolina	D	C	6.5	102
MFS M-S Muni Bond–S Carolina	C	D	7.1	105
MFS M-S Muni Bond–Virginia	D	B	6.9	102
MFS Municipal Bond	A	D	9.3	77
MFS Municipal Income Trust*	F	A+	7.7	64

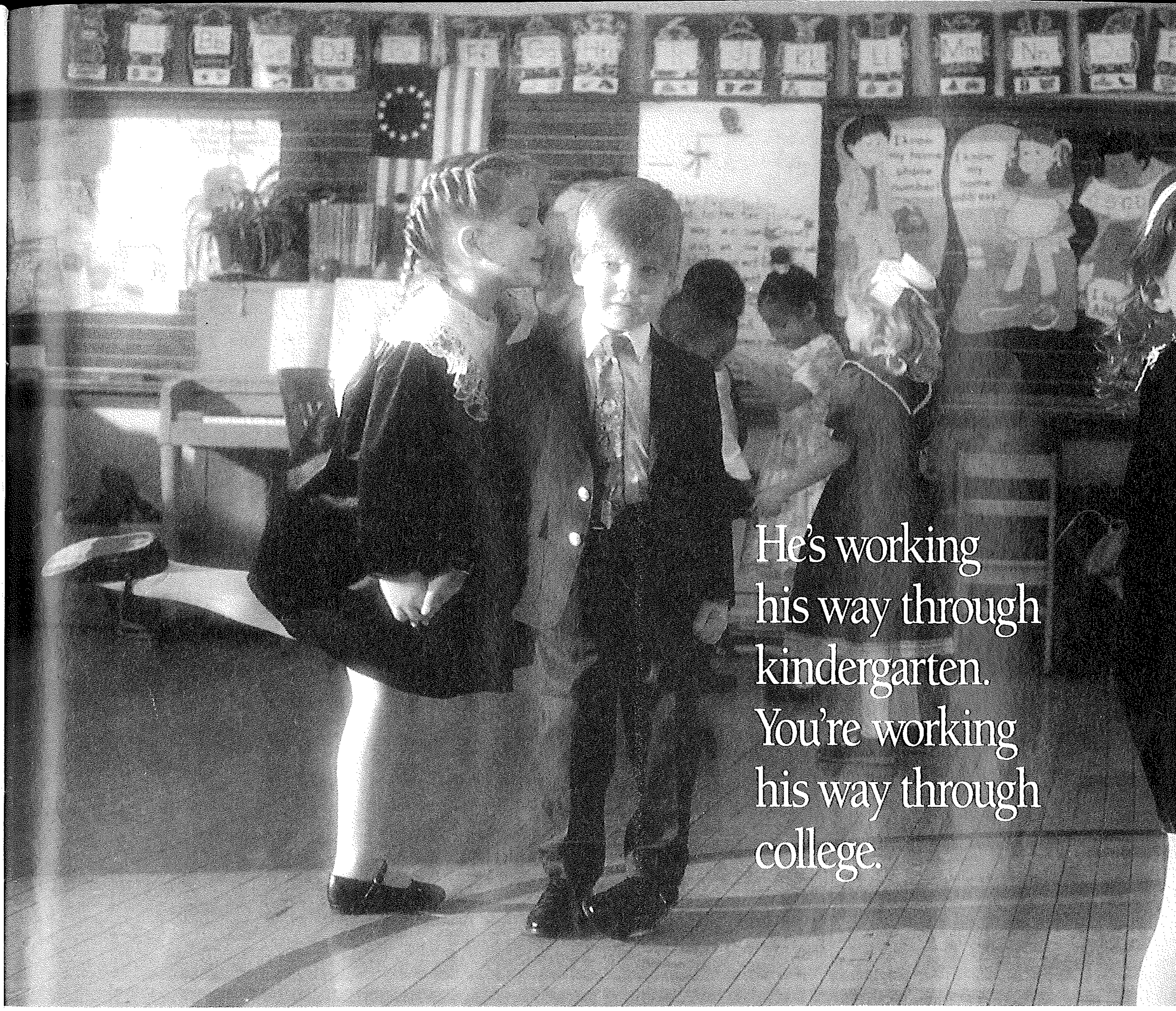
*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

MUNICIPAL BOND FUNDS

Fund	Performance in UP —markets—	Performance in DOWN —markets—	12-month total return	5-year cumulative expense†
Municipal High Income Fund*			8.8%	$44
MuniEnhanced Fund*			12.4	35
MuniVest Fund*			10.7	33
Mutual of Omaha Tax-Free Inc	A	D	8.7	91
National Calif Tax-Exempt Bonds	D	B	6.9	82
National Securities T-E Bonds	B	C	8.4	84
Nationwide Tax-Free Income	B	D	9.4	49
New York Muni Fund	A	F	11.9	86
Nuveen Calif Insured T-F Value	A	D	9.3	80
Nuveen Calif Invest Quality Muni*			11.4	38
Nuveen Calif Muni Market Oppor*			10.9	40
Nuveen Calif Muni Value*	D	A	7.9	40
Nuveen Calif Perform Plus Muni*			11.7	40
Nuveen Calif Quality Inc Muni*			9.1	38
Nuveen Calif Select Quality Muni*			11.0	40
Nuveen Calif T-F Value	C	B	9.2	81
Nuveen Florida Invest Quality Muni*			10.7	39
Nuveen Insured Muni Bond	A	D	9.6	84
Nuveen Insured Muni Opportunity*			11.1	37
Nuveen Insured Quality Municipal*			11.6	38
Nuveen Invest Quality Muni*			11.0	37e
Nuveen Michigan Quality Inc Muni*			11.2	41
Nuveen Municipal Advantage Fund*			9.0	37
Nuveen Municipal Bond Fund	D	B	8.5	79
Nuveen Municipal Market Oppor*			11.1	37
Nuveen Municipal Value Fund*	B	B	9.1	40
Nuveen NJ Invest Quality Muni*			10.1	38
Nuveen NJ Quality Inc Muni*			10.1	44
Nuveen NY Insured T-F Value	B	C	9.7	82
Nuveen NY Invest Quality Muni*			12.7	40
Nuveen NY Muni Market Oppor*			12.7	42
Nuveen NY Muni Value*	C	B	9.3	42
Nuveen NY Performance Plus Muni*			12.6	41
Nuveen NY Quality Inc Muni*			10.5	40
Nuveen NY Select Quality Muni*			12.6	42
Nuveen Ohio T-F Value	A	D	9.4	83
Nuveen Penn Invest Quality Muni*			11.9	39
Nuveen Penn Quality Inc Muni*			11.2	44
Nuveen Performance Plus Muni*			10.6	37
Nuveen Premier Insured Muni Inc*			10.1	37
Nuveen Premier Muni Inc*			10.1	38
Nuveen Premium Income Muni*			10.0	33
Nuveen Quality Income Municipal*			11.7	39e

Fund	Performance in UP —markets—	Performance in DOWN —markets—	12-month total return	5-year cumulative expense†
Nuveen Select Quality Municipal*			10.5%	$40e
Nuveen Texas Quality Inc Muni*			10.1	43
Oppenheimer Calif Tax-Exempt			7.7	100
Oppenheimer New York Tax-Exempt	D	B	9.0	96
Oppenheimer Tax-Free Bond	C	C	9.7	96
Overland Express Calif T-F Bond			9.1	73
Pacific Horizon–Calif T-E Bond	D	C	8.6	96
Pacifica Calif Tax-Free			8.2	84
PaineWebber Calif T-F Income	C	B	7.5	88
PaineWebber Natl T-F Income	B	D	7.7	86
Parkstone Michigan Muni Bond			7.0	82
Parkstone Municipal Bond			7.4	81
Piper Jaffray Minnesota Tax-Exempt			8.1	86
Premier Calif Muni Bond	B	B	8.3	69
Premier Municipal Bond	A	B	10.0	72
Premier State Muni–Conn	B	C	8.7	71
Premier State Muni–Fla	A	C	9.0	71
Premier State Muni–Md	B	C	8.3	72
Premier State Muni–Mich	A	D	9.3	72
Premier State Muni–Minn	B	B	8.4	72
Premier State Muni–Ohio	B	B	9.4	71
Premier State Muni–Penn	A	B	9.8	73
T Rowe Price Calif T-F Income Bond*	C	C	8.9	30
T Rowe Price Maryland T-F Bond*	C	D	8.5	32
T Rowe Price Tax-Free High Yield*	D	A	9.6	42
T Rowe Price Tax-Free Income*	C	D	9.4	31
T Rowe Price T-F Short Intermed*	F	A	6.0	34
Prudential Calif Muni–Calif	C	C	8.8	50
Prudential Calif Muni–Income			10.1	50
Prudential Muni Bond–High Yield			8.8	44e
Prudential Muni Bond–Insured			8.4	89e
Prudential Muni Ser–New Jersey			9.0	67e
Prudential Muni Ser–New York	C	C	9.9	82e
Prudential Muni Ser–Ohio	B	D	9.0	86e
Prudential Muni Ser–Penn	A	D	9.6	85e
Prudential Natl Municipals	B	D	8.9	90e
Putnam Calif Tax-Exempt Income	B	C	8.5	76
Putnam Florida Tax-Exempt Income			9.6	78
Putnam High Yield Municipal Trust*			12.7	57
Putnam Investment Grade Muni*			14.0	73e
Putnam Managed Muni Income*			13.3	67e
Putnam Mass Tax-Exempt Inc II			10.7	92
Putnam Muni Income			11.3	93

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.



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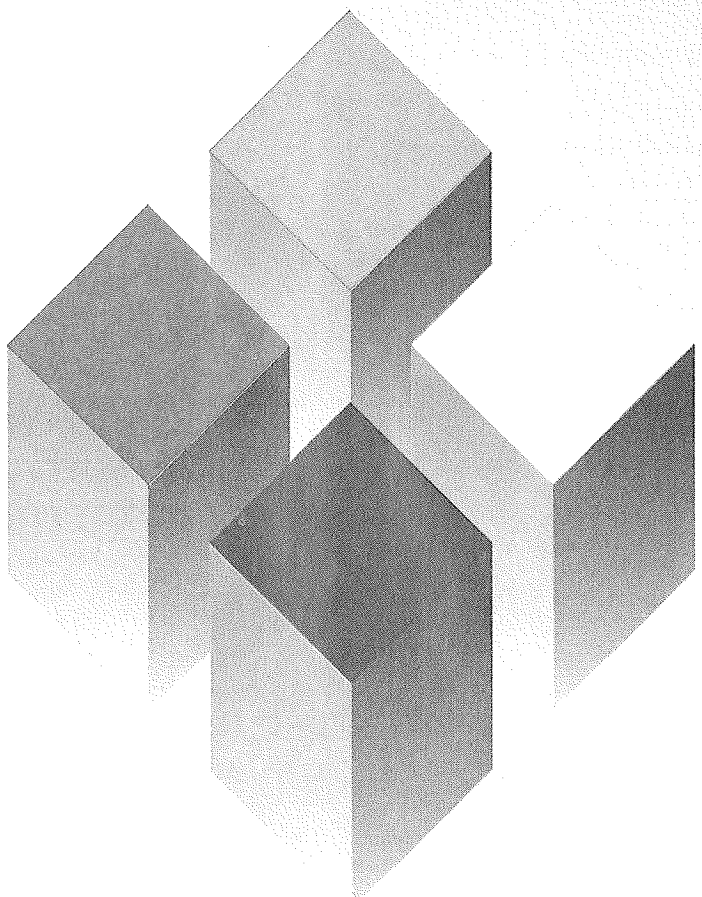
Fund	Performance in UP —markets—	Performance in DOWN —markets—	12-month total return	5-year cumulative expense†
Putnam New Jersey Tax-Exempt Inc			8.7%	$85
Putnam New York Tax-Exempt Inc	A	D	10.4	79
Putnam Ohio Tax-Exempt Income II	C	C	8.9	93
Putnam Penn Tax-Exempt Income			9.6	74
Putnam Tax-Exempt Income	A+	F	10.5	81
Putnam Tax-Free Income–Hi Yld	D	A	10.6	73
Putnam Tax-Free Income–Insured	B	D	7.1	90
Rochester Fund Municipals	D	A+	11.2	80
Safeco Municipal Bond Fund*	A+	D	8.7	27
Scudder Calif Tax-Free Fund*	A	C	9.4	41
Scudder High Yield Tax-Free*	A	C	10.9	51
Scudder Managed Muni Bonds*	A	D	9.0	32
Scudder Massachusetts Tax-Free*	A+	F	10.8	24
Scudder NY Tax-Free*	B	D	10.2	44
Seligman Select Municipal*			11.8	45
Seligman Tax-Exempt–Mass	B	D	9.2	86
Seligman Tax-Exempt–Michigan	A	D	9.3	86
Seligman Tax-Exempt–Minnesota	C	D	7.7	87
Seligman Tax-Exempt–National	A+	F	7.9	86
Seligman Tax-Exempt–Ohio	B	D	8.4	86
Shearson Calif Municipals	B	C	8.0	83
Shearson Income–Tax-Exempt Inc	D	B	8.9	73
Shearson Managed Municipals	A	D	9.3	80
Shearson NJ Municipals			9.4	84
Shearson NY Municipals	D	A	9.3	82
Sierra–Calif Muni Income			9.2	88e
Sierra–Natl Muni Income			10.1	82e
Sit New Beginning T-F Income*			7.7	40
Smith Barney Muni Bond–Calif	B	C	8.6	51
Smith Barney Muni Bond–Ltd Term			8.1	45e
Smith Barney Muni Bond–Natl	A	C	9.3	60
Spartan California Muni High Yield*			8.8	18
Spartan Conn Muni High Yield*			8.2	27
Spartan Municipal Income*			8.4	18
Spartan New Jersey Muni High Yield*			8.7	25
Spartan New York Muni High Yield*			9.4	19
Spartan Penn Muni High Yield*	A	C	9.1	28
Spartan Short-Intermed Muni*	F	A+	6.2	28
SteinRoe High Yield Municipals*	D	A	5.4	35
SteinRoe Intermediate Munis*	D	B	7.6	40
SteinRoe Managed Municipals*	B	C	8.3	32
Strong Municipal Bond Fund*	D	B	12.4	5
SunAmerica Tax-Ex–Insured	D	A	6.6%	$110
Taurus MuniNewYork Holdings*			11.8	42
Tax-Ex Bond Fund of America	C	D	9.3	83
Tax-Ex Fund of California	C	D	8.5	85
Tax-Free Fund of Colorado	D	A	9.0	62
Tax-Free Trust of Arizona	C	B	9.5	69
Tax-Free Trust of Oregon	D	B	7.7	76
TNE Tax-Exempt Income	B	D	8.3	93
Transamerica Calif Tax-Free Inc			9.1	68
United Municipal Bond Fund	A+	F	9.5	72
United Municipal High Income	D	A	10.1	80
USAA Tax-Exempt–Calif Bond*			8.3	24
USAA Tax-Exempt–Intermediate*	D	A	8.5	22
USAA Tax-Exempt–Long-Term*	B	C	8.6	20
USAA Tax-Exempt–Short-Term*	F	A+	5.9	24
USAA Tax-Exempt–Virginia*			8.5	25
UST Master Tax-Exempt–Intermed	D	B	8.4	77
Value Line Tax-Exempt–Hi Yld*	D	B	7.8	29
Van Kampen Calif Quality Muni*			11.1	78
Van Kampen Florida Quality Muni*			12.9	80
Van Kampen Insured Tax-Free	B	C	9.5	90
Van Kampen Muni Income Trust*			14.0	68
Van Kampen Muni Income			9.7	91
Van Kampen Muni Trust*			13.2	75
Van Kampen Penn Quality Muni*			15.2	79
Van Kampen Penn Tax-Free Inc	B	B	10.1	84
Van Kampen Tax-Free High Inc			0.1	100
Vanguard California T-F–Ins L-T*	A+	F	9.3	13
Vanguard Muni Bond–High Yield*	A+	D	9.9	12
Vanguard Muni Bond–Ins L-T*	A+	F	9.2	12
Vanguard Muni Bond–Intermed*	C	C	8.9	12
Vanguard Muni Bond–Ltd Term*	D	A	6.4	12
Vanguard Muni Bond–L-T*	A+	F	9.3	12
Vanguard Muni Bond–S-T*	F	A+	4.7	12
Vanguard NJ Tax-Free–Ins L-T*			9.4	13
Vanguard New York Insured T-F*	A	D	9.7	13
Vanguard Penn Tax-Free–Ins L-T*	A	D	10.1	13
Venture Muni (+) Plus	D	A	8.4	120
Voyageur Colorado Tax-Free	C	A	10.4	80
Voyageur Minnesota Insured	D	A	10.3	67
Voyageur Minnesota Tax-Free	D	A	8.0	89

*Fund has no load or shareholder-paid 12b-1 plan. † See page 166 for explanation. e: Estimate.
Sources: CDA/Wiesenberger; Lipper Analytical Services; Morningstar; Forbes.

Forbes
MUTUAL FUNDS PORTFOLIO



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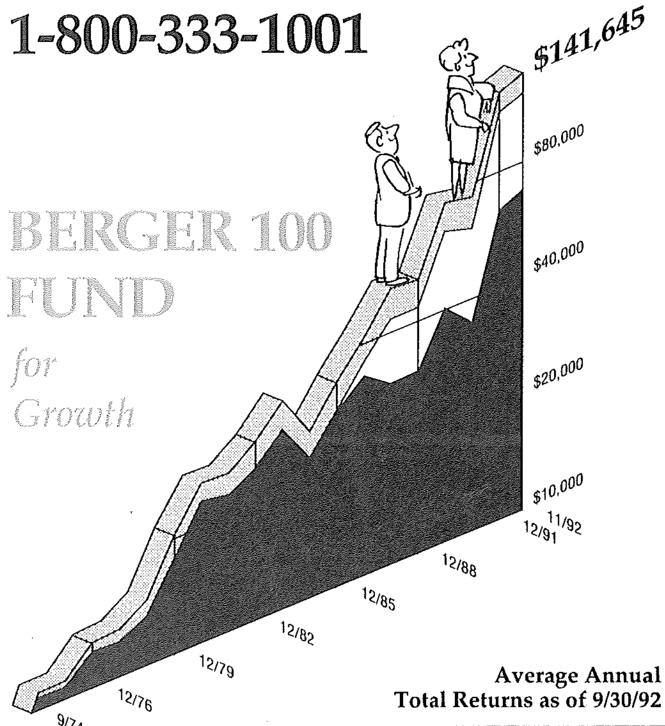

Value added by reinvested dividends.
Value added by reinvested capital gains.
Value of shares initially acquired.

Average Annual Total Returns as of 9/30/92

	BERGER 100 FUND	BERGER 101 FUND
1 YEAR	7.0 %	8.0 %
3 YEAR	17.6 %	13.3 %
5 YEARS	18.0 %	8.3 %
10 YEARS	16.6 %	15.6 %
15 YEARS	15.9 %	12.4 %
From 9/30/74	15.0 %	13.6 %

Past performance shows the fund's history and does not guarantee future results. The figures include changes in share price and reinvestment of dividends and capital gains, which will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. The figures include the deduction of 12b-1 fees beginning in June, 1990. Source: Lipper Analytical services. 5

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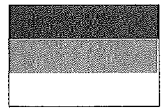

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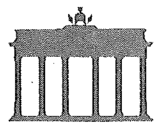
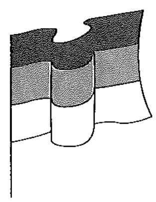


THE NEW GERMANY FUND, INC.

– investing primarily in the middle-market German companies, and up to 20% outside Germany (with no more than 10% in any single country outside Germany).



THE FUTURE GERMANY FUND, INC.

– similar to Germany Fund but with an emphasis on companies benefiting from developments in the former "East Germany" as well as Eastern Europe.

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Mario J. Gabelli

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THE GABELLI GROWTH FUND

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This Fund is managed by G.T. Global, one of today's most respected global money managers. To find out more about G.T. Global's unique perspective on U.S. investing — and the G.T. America Growth Fund's performance — call or write today. $500 minimum, $100 for IRAs.

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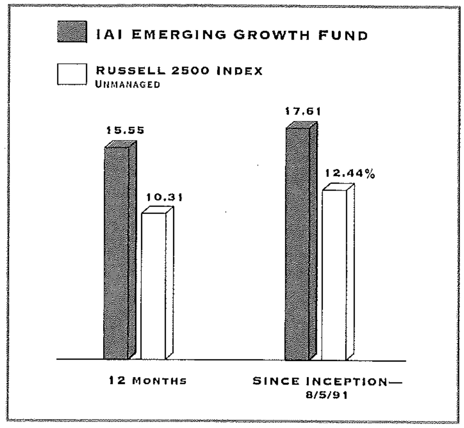
IAI EMERGING GROWTH FUND



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Results as of 9/30/92. The Russell 2500 is an unmanaged index and may be a trademark. Past performance is not a guarantee of future results. Share price will vary, and redemption price may be more or less than original cost. Performance figures include reinvestment of income and capital gain distributions. Please read the Fund Prospectus carefully before investing. Fund distribution by IAI Securities, Inc. Member SIPC.

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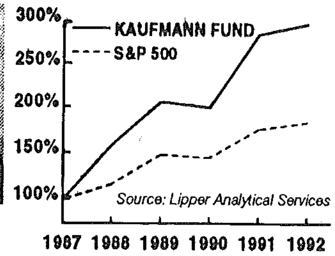

Outperformed all funds, with more than twice the average total return.

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• Morningstar 5 Star (*****) Rating

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*Period ending 12/31/92.
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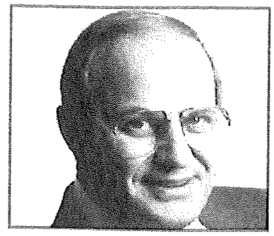

Julian P. (Bing) Carlin
IAI Regional Fund Manager

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*ICI 1/9/92

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Quest For Value Family of Funds

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LEGG MASON
Special Investment Trust

5 out of 5

THE FUNDS TOTAL RETURN AS OF DECEMBER 31, 1992	CUMULATIVE TOTAL RETURNS	AVERAGE ANNUAL TOTAL RETURNS
ONE YEAR 12/31/91 – 12/31/92	15.36%	15.36%
FIVE YEAR 12/31/87 – 12/31/92	155.65%	20.65%
LIFE OF FUND 12/30/85 – 12/31/92	145.77%	13.70%

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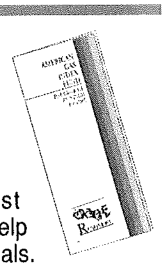
RUSHMORE AMERICAN GAS INDEX FUND



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The World Economic Forum thanks Nicolas Hayek, Chairman of the Omega Watch Company and Donald Keough, President and COO of the Coca-Cola Company, for their invaluable support and involvement. Should you wish to learn more about this on-going initiative or about our other activities, we invite you to contact us.

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The Korean stock market looks tempting to foreign investors. But the Korean government wants to make sure they don't get any bargains.

A half-open door

By Damon Darlin

U.S. AND OTHER foreign money is pouring into the Korean stock market. Of last year's total $2 billion, the majority came in during the final three months. In the first seven days of January, $146 million arrived, 27% more than a year earlier. It has been attracted by a booming stock market. The Korea Stock Exchange Index, under 500 in August, was recently at 707, up more than 50%.

The Korean government finally opened the country's stock market to direct investment from abroad in January 1992, but complicated registration rules and limits on stock purchases, combined with Korea's political problems, dampened interest. Other Asian economies, notably Thailand and Hong Kong, looked stronger.

Then, late last year, the Korean market took off on clear signs of falling interest rates and stronger exports. The market got another push after the Dec. 18 election of Kim Young Sam as president, promising political stability.

Korea's gross national product is expected to grow about 5.5% this year, slow by Korean standards but among the world's better performers. James Capel Inc. expects Korea's stock market to be one of Asia's best performers this year.

"Last year Hong Kong was hot because everyone was thinking of China. But people now are realizing that Korea may be a better China play," says Robert K. Kim, the manager of the Korean Investment Fund at Alliance Capital Management Corp. "Korea is investing now and selling their goods there, but it doesn't have the political risk that Hong Kong carries." Kim has put almost a third of the fund's money into construction and steel stocks, partly to catch that anticipated boom.

Unfortunately, foreigners wishing to invest in Korea face a deck stacked against them by the Korean government. In almost all companies, foreign investors can own no more than 10% of a company's shares. Quality stocks, such as Pohang Iron & Steel or Hyundai Motor Service, have long since hit their foreign ownership ceilings. Once the ceiling is hit, a foreigner can buy stock only from another foreigner. The result is a two-tier market: one price for Koreans, another for foreigners.

Premium plays

Fund	Exchange	Market cap ($mil)	Recent price	Net asset value	Premium/ discount	—Premium/discount*— high	low
Korea Fund	NYSE	$275	15	$11.14	34.7%	120%	-87%
Korean Investment Fund	NYSE	40	11½	10.52	9.3	27	1.0
Daehan Asia Trust	Hong Kong	91	8⅞	9.74	–8.9	1	–28
Daehan Korea Trust	London	31	6⅜	7.72	–17.1	22	–39
Korea 1990 Trust	Hong Kong	23	3⅛	3.78	–16.7	19	–33
Korea Asia Fund	Hong Kong, London	111	11¾	12.04	–2.4	530	–27
Korea Equity Trust	Hong Kong	24	6¼	7.69	–18.7	23	–61
Korea Europe Fund	London	113	5½	5.25	4.8	47	–36
Korea Growth Trust	Hong Kong	38	29¾	29.50	0.9	22	–37
Korea International Trust	unlisted	100	39	38.73	0.7	45	–17
Korea Liberty Fund	London	36	5¾	6.19	–7.1	31	–36
Korea Pacific Trust	Amsterdam	71	8½	–6.4	9.1	12	–34
Korea Trust	London	109	49	48.92	0.2	441	–50
Seoul Asia Index Trust	Singapore	51	8⅜	9.15	–8.5	302	0
Seoul International Trust	unlisted	98	39	37.83	3.1	80	–20
Seoul Trust	unlisted	116	29	28.53	1.7	66	–35

*Since Dec. 31, 1989.
Source: Robert Fleming Inc.

Premiums can be high on popular publicly traded Korea funds, but those trading at discounts aren't necessarily bargains—just a little harder to get in and out of because they are less liquid.

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Each Anacomp fiche is a 4"x 6" sheet of microfilm that holds up to 700 pages of information. In most cases, fiche can be retrieved and used more quickly than competing media such as magnetic tape and optical disc. Most important, savings in the cost of paper, storage space, mailing costs, and manpower make fiche far and away the most cost-effective way to store and retrieve data.

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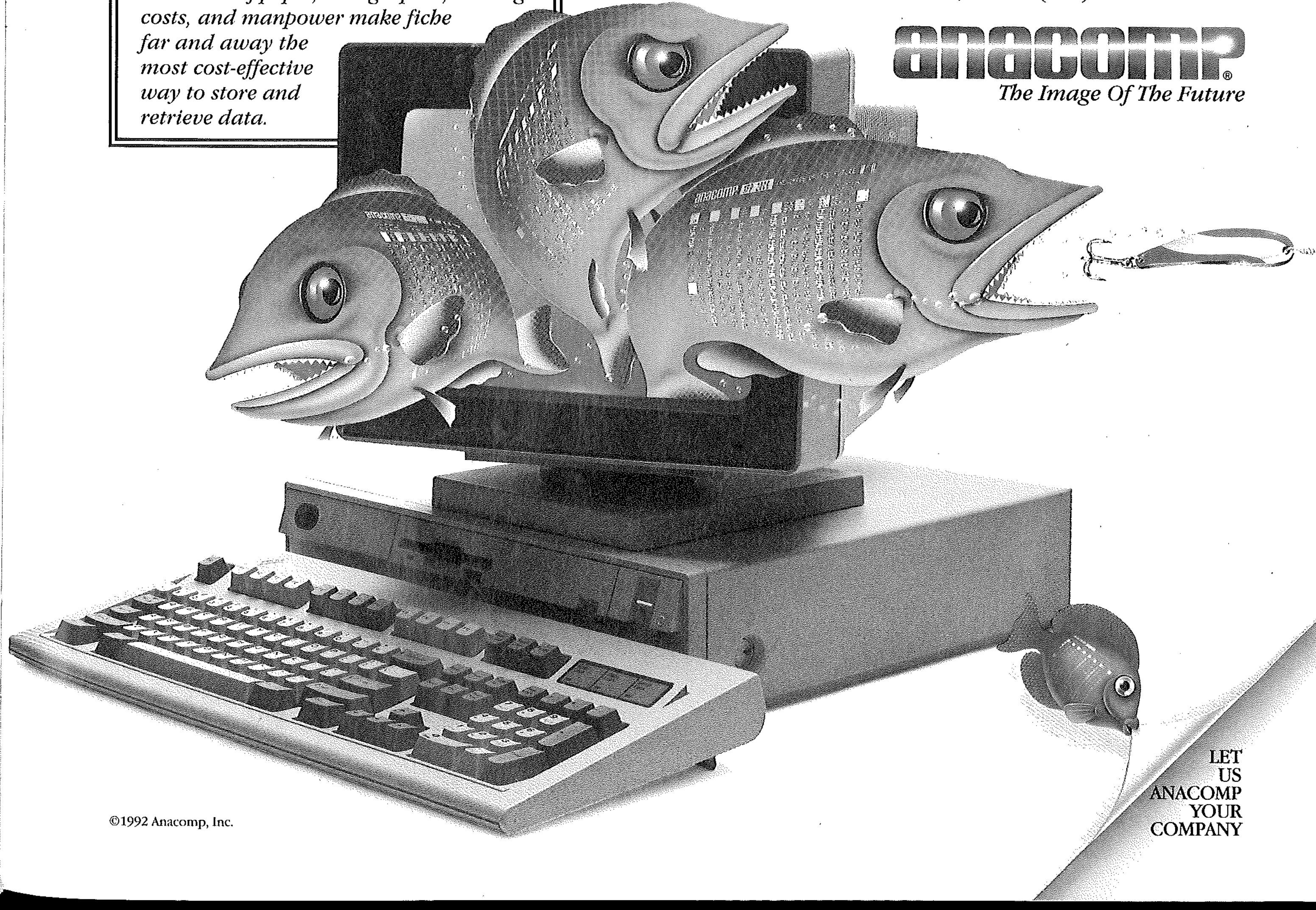
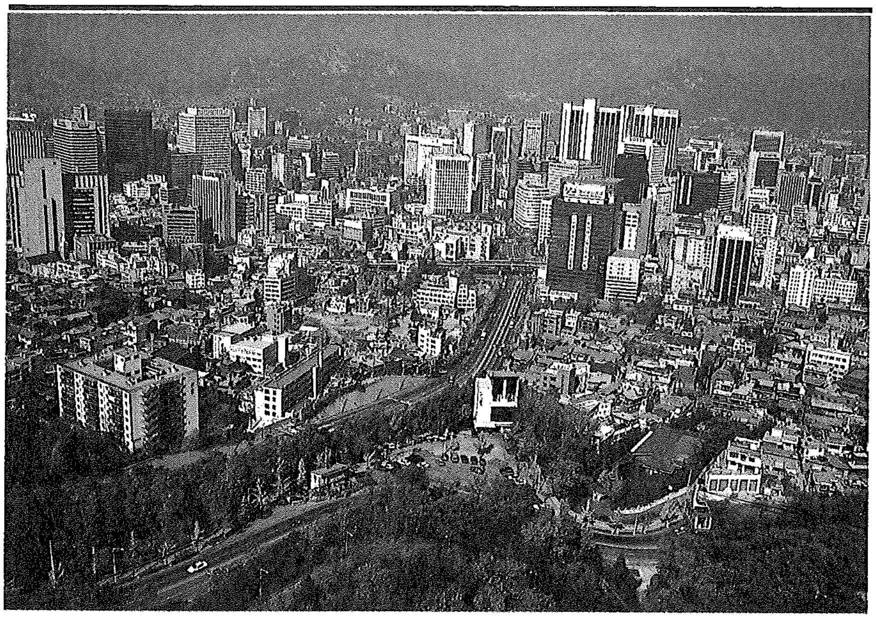




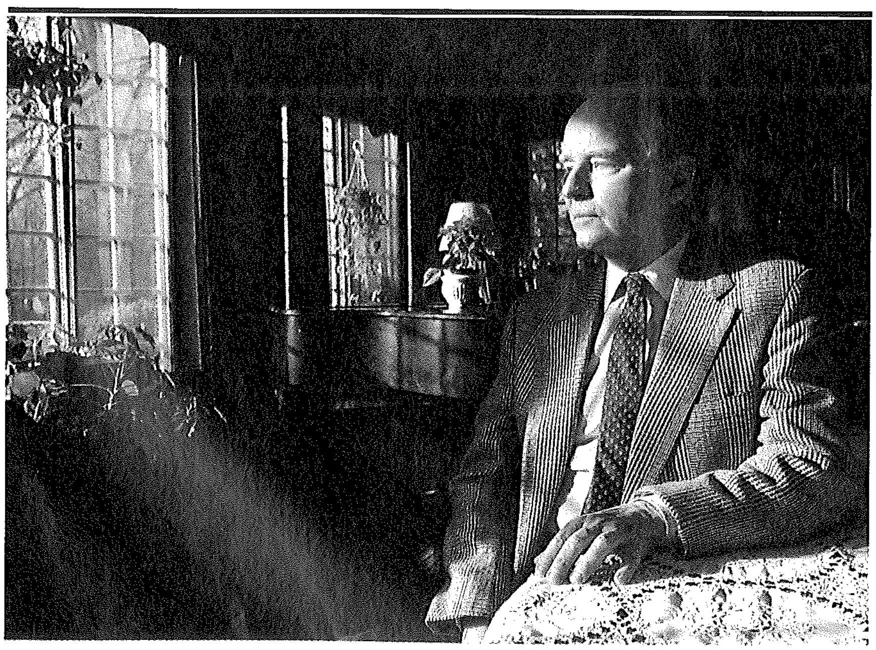
Miwako Ikeda/International Stock

Sprawling Seoul

GNP is expected to grow about 5.5% this year, slow by Korean standards.

Take Korea Mobile Telecommunications, the country's cellular phone monopoly. For Koreans it trades at 120,100 won ($152) a share, only about 10 times 1993 earnings, while the average Korean price/earnings ratio is 13. But, for foreigners buying from other foreigners, the price is 210,175 won, a 75% premium.

Where there's a will, there's a way. With permission from the Korean government, Harry Seggerman, a Fairfield, Conn. money fund adviser who once ran the Japan Fund, established the Daehan International Investment Trust. Ostensibly managed by a Korean group, Daehan Investment Trust Co., an investors' council led by Seggerman has ultimate control over the portfolio. Seggerman raised $30 million from such names as the General Electric pension fund, Rockefeller & Co., Fayez Sarofim and TV personality George Jerry Goodman ("Adam Smith").



Gabe Palacio

Fund adviser Harry Seggerman

His Daehan fund made it easier for foreigners to buy Korean stocks.

About a dozen similar funds have attracted another $500 million. Although Seggerman originated the concept, Jardine Fleming, the Hong Kong-based securities firm, beat Seggerman to market with an offering of Seoul Horizon Trust in May 1992 for $50 million raised from clients in the U.S. and Britain. Other such funds followed: Korea Rising Trust, Korea Oriental Trust and Korea Anglo-American International Trust.

"They are a way for foreigners to bypass restrictions," says Philip Smiley, branch manager of Jardine Fleming Securities in Seoul. For the usually xenophobic Ministry of Finance, the onshore trusts provided a much needed infusion of money into a then sagging stock market.

Short of participating in one of these pools, can an investor buy a piece of Korea without paying a huge premium? Not easily. To invest in individual stocks, one needs a special identification card issued by the Korean Securities Supervisory Board. For most investors, therefore, the best way into Korea remains the Korea Fund and the newer Korean Investment Fund; both are closed-end country funds listed on the New York Stock Exchange. But they face the same foreign-ownership limits on their trades. A further disadvantage is that these funds trade at substantial premiums above the net asset value—in the case of the Korea Fund, as much as 35%.

There are also about 15 offshore funds trading in Hong Kong, London or smaller markets *(see table, p. 188)*. Most of them trade at discounts—and for good reason. They are difficult to get in and out of because they are relatively shallow pools of capital with small numbers of thinly traded shares outstanding.

Investors expect Finance Ministry bureaucrats to make things easier for would-be foreign investors later this year by raising the foreign ownership ceilings to 15% from 10%. Before then, of course, Korean speculators will have pushed up prices of the stocks foreigners most covet. ■

Michael Smith is one oilman who hopes oil prices stay down.

Scavenger

By William P. Barrett

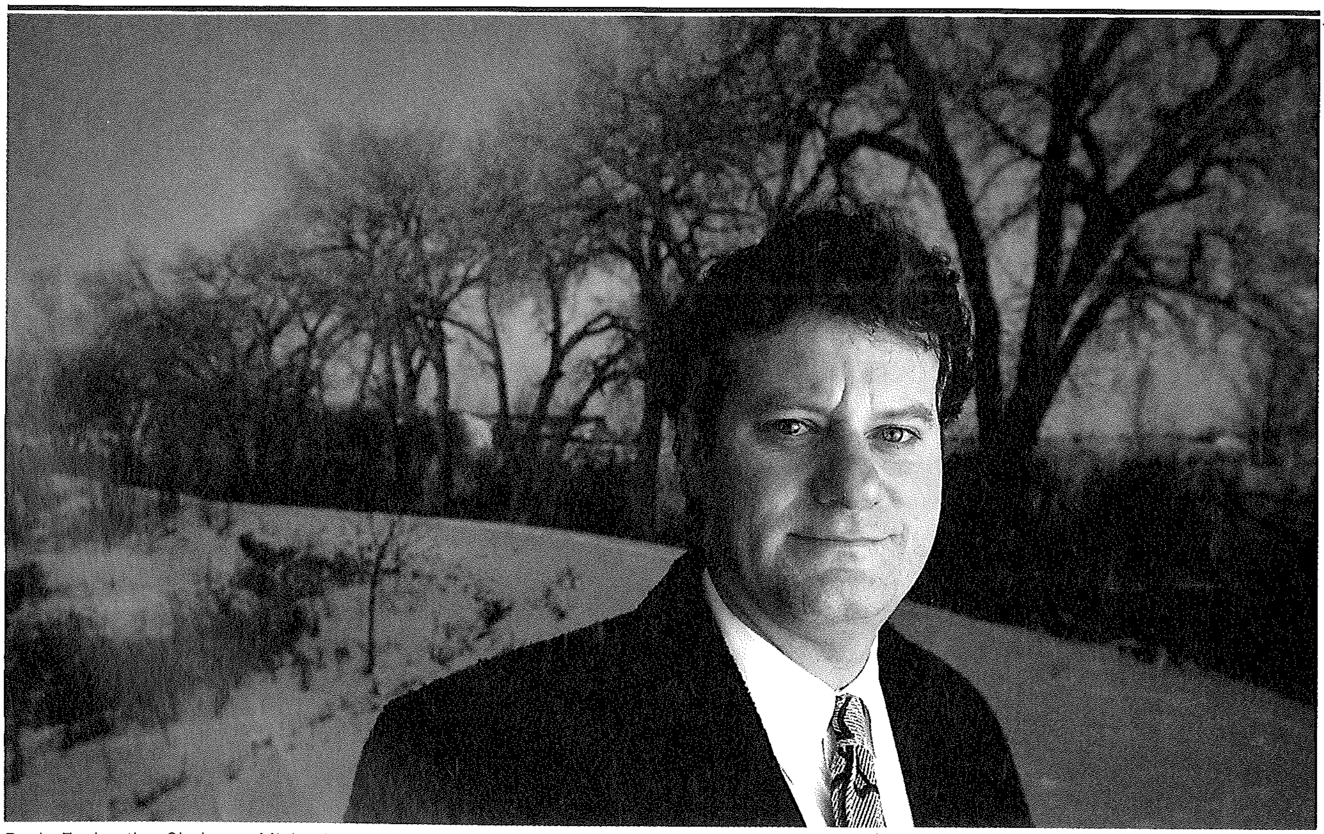
THE PAST COUPLE YEARS have not been happy ones in the oil business, but they have been sweet years indeed for Michael Smith, who heads Denver-based Basin Exploration Inc. (expected 1992 revenues, $21 million). Smith, 37, has developed a specialty of finding oil and gas in nooks and crannies across the Rocky Mountains. He's so good at it that his 58% holding of publicly owned Basin, traded over the counter, has a market value of about $50 million.

The Rockies have suddenly become a hot region for smaller oil companies with little overhead and lots of hustle. Major operators such as Texaco, Exxon and Amoco today prefer to seek monster new fields rather than fuss with the little stuff. For this reason the big fellows are deploying their exploration and development bucks overseas. They are unloading at attractive prices relatively tiny domestic properties, some barely touched in years.

Despite the company's name, the hulking, curly-haired Smith is more into development than exploration. "We don't take much exploration risk," he says. His company specializes in recompleting existing wells, which might involve seeking a different geological zone in the same well. A new well can cost $200,000; a recompleted one, just $65,000. And the job often can be done in less than a week.

Says Smith, "We do low-risk stuff." This approach eschews the chances of a big killing but provides steady and dependable returns. Smith looks for deals where he can get his money back within five years—and an annual internal rate of return of 30% or more.

Michael Smith is a transplanted easterner. Reared on Long Island, Smith went west nearly 20 years ago to attend Colorado State University in Fort Collins, 60 miles north of Denver. He studied chemistry but left in 1978 just shy of graduation—to ski in Vail, he says. He then took a real estate license in Fort Collins and quickly moved into land development and speculation. He eventually hooked up with oil types—and developed a bad case of black gold fever. With two real estate acquaintances, Les Kaplan and Frank Camera, Smith founded Basin in 1981, using $60,000 of their own money, and drilled several wells—successfully. "This seemed pretty easy," Smith says.



Jay Dickman

Basin Exploration Chairman Michael Smith
"We do low-risk stuff."

It wasn't. Camera quit in 1982, leaving Smith and Kaplan. Despite the initial success and funding from several drilling limited partnerships—not always successful—Basin stagnated for several years, losing money in 1987. In September 1988 Smith agreed to pay Kaplan, who today doesn't talk about Smith, an estimated $500,000. That stake would now be worth about $25 million.

On his own, Smith had to scramble for financing. He tapped his oil services suppliers and such sources as a Coopers & Lybrand partners deferral plan. He also took out 11 separate notes and mortgages and used money earmarked for property taxes. He moved the company from Fort Collins to Denver in 1989.

A very tough negotiator, Smith proved pretty good at promoting himself and raising money, and from 1988 on was able to spend $30 million to buy energy properties that he now values at more than double that. Basin, with over 1,300 operating wells, has probably become one of the biggest independent operators in Colorado.

Smith's capital woes eased considerably when Donaldson, Lufkin & Jenrette raised about $25 million from selling the public 42% of the company last spring to pay down debt. Until then Smith was personally guaranteeing something like $24 million. "I sleep better now," he grins. He will sleep even better when, as he hopes, Basin taps the equity markets again in the near future.

Basin is expected to report earnings of $3.4 million, or 55 cents a share, for 1992. Some analysts expect per-share earnings to more than double this year. In another sign of Smith's growing prominence, his board now includes veteran oil investor Michael A. Nicolais, who just retired after 40 years of helping to manage the Forbes Four Hundred fortune of the Clark family of Cooperstown, N.Y. (FORBES, *Sept. 18, 1989*).

While most oilmen pray for better prices, the cocky Smith is hoping that oil prices will stay put for the next year or two. This is partly because he has hedged some of this year's production. More important, he wants to continue acquiring properties. Cheaply.

Kidnappers, carjackers and urban guerrillas have created a nice little business for Cincinnati's O'Gara brothers.

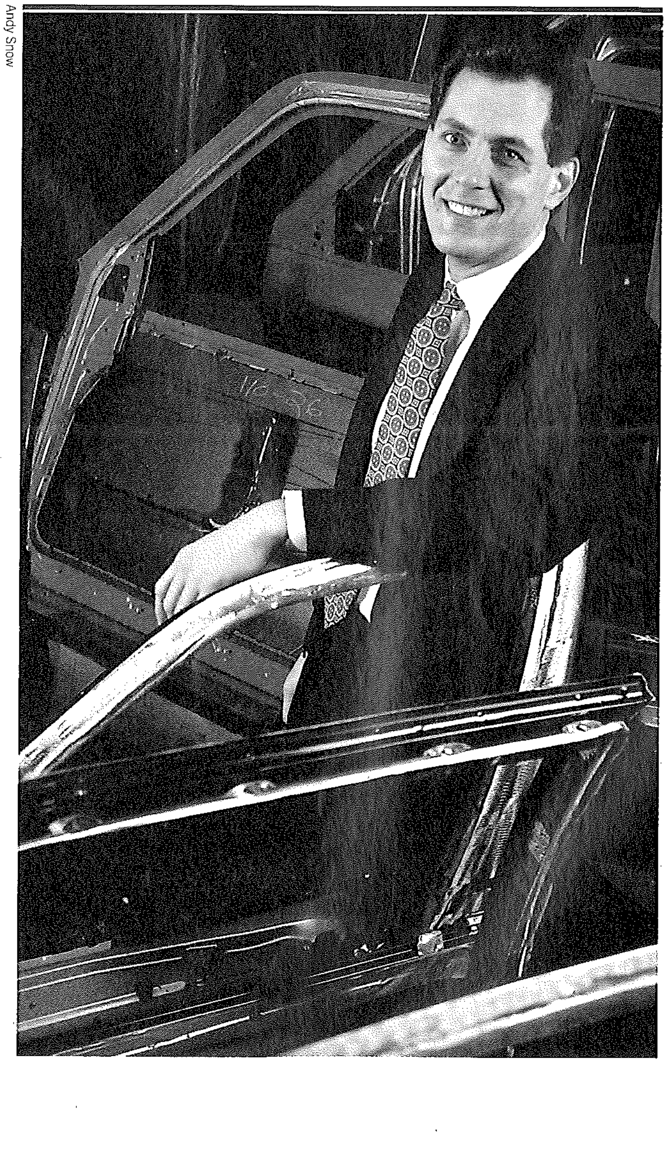
Opportunities in terrorism

By Jerry Flint

BILL O'GARA was reminiscing a bit: "The business grew after Kennedy was assassinated. By the late 1970s, terrorism in vehicles was a threat—remember when the Turkish ambassador was shot to death in L.A.?" The PLO and Mossad were at war back then, he continues. There were the Red Brigades, the Baader-Meinhof gang, Qaddafi, Carlos and the IRA, all the great names in terrorism.

But one man's terrorist is another man's business opportunity, and 35-year-old Bill O'Gara and his brother

Andy Snow



O'Gara-Hess & Eisenhardt President Bill O'Gara **"Regional complications are better for us than a major war."**

Thomas, 42, are exploiting the opportunities in terrorism beautifully.

The O'Gara brothers own O'Gara-Hess & Eisenhardt, specialists in the armor-plating of cars. The company is run out of a plant in Fairfield, Ohio, 10 miles north of Cincinnati. Revenues come to a nice, steady $20 million a year, pretax profits to between $1 million and $2 million. Bill O'Gara is in charge of production. Brother Tom heads up marketing.

Aren't East Germany's Stasi and the KGB out of the international terrorism business? Yes, but there is no end of newcomers to replace them. Just read the headlines: gunmen stopping cars in Somalia, the deputy prime minister of Bosnia assassinated riding from Sarajevo's airport, the Exxon executive kidnapped from his car and murdered in New Jersey, attacks on whites in South Africa, kidnapping in Brazil, snipers in Florida, the drug lords' car bombs in Latin America, carjacking in lots of American cities.


Andy Snow

Disassembling cars for armoring
It costs up to $70,000 to stop a 9mm bullet.

"Look at Turkey now," says Bill O'Gara. "There's a terrific level of internal violence there. People get shot in their cars. Keep your eyes on Turkey." He thinks recent developments in Thailand and the Philippines will be good for his business, too.

"Regional complications are better for us than a major war," he adds. "In a major war, the tanks and submarines and bombers take over, not thick glass."

The O'Garas' window glass runs up to 2½ inches thick, and their car armor comes in three materials—metal, fiber and ceramic. The full-metal armor treatment, able to withstand an armor-piercing shell, weighs about 1,800 pounds and costs upwards of $100,000 (plus the car). Lighter-weight fiber protection can check a 9mm bullet; this treatment adds about 300 pounds and costs from $40,000 to $70,000 and up on an S Class Mercedes (plus the car). There are more expensive light armors, but American law forbids exports of some of these high-technology materials. Over 90% of the O'Garas' revenues are booked from sales overseas; more than half the brothers' vehicles go to the Middle East.

The company plates between 200 and 250 vehicles a year—Cadillac limousines, Jeep Grand Cherokees, GMC Suburbans for Africa, Chevy vans for U.S. agencies.

Just the thing for dope dealers? "No," O'Gara replies. "We're pretty careful who we deal with. With 90% of our business with governments and 7% corporations, we can't afford to be indiscriminate."

These days the O'Gara brothers are mulling the sharp rise in carjackings, but they're not quite sure how to play the trend.

"We see potential for a PSV [Personal Security Vehicle]," Bill O'Gara says. "But we have problems with expanding into this business. What do you do? Do you put some protection in the left front door? Or all four doors? What is our liability? We are not equipped to handle a consumer market."

Still, opportunity is knocking and the O'Garas must consider it. The brothers say they are talking with Cadillac executives about the possibility of offering light fiber armor in doors. Target cost of this option: around $5,000. Tom O'Gara thinks they might get orders for 2,000 vehicles a year—a figure that would increase their revenues by half.

The brothers tried to create a personal security vehicle in 1988. "We were after the smash-and-grab market, a brick or a tire iron in the window and some guy grabs your purse," says Tom O'Gara. But the package they came up with then cost $20,000. No one wanted it at that price, and O'Gara-Hess & Eisenhardt lost money that year.

How does one get into such a business? In 1978 Tom O'Gara was selling Ferraris, Rolls-Royces, Lamborghinis and other exotic cars in Beverly Hills. This led him into converting production-line Cadillacs, Lincolns and Mercedes-Benzes into limousines. This was a big business for a few years, and Tom O'Gara brought in brother Bill to help him run it. But soon competition made the conversion business unprofitable. "Anyone could saw a car in half and put in a TV," says Tom.

The limo business collapsed in the mid-1980s. But many of the O'Gara boys' customers were Arabs who wanted secure cars. This led the brothers to buy century-old Hess & Eisenhardt in 1982. Before the O'Garas bought it, Hess & Eisenhardt built hearses.

Still young, the O'Garas think they have barely scratched the surface of demand for their services. "We have no serious long-term debt," says Tom O'Gara. "We'll take sales to $100 million in the next five years, then blow it out"—meaning he plans to take the company public then.

A dream? Maybe not. "I don't see the trend toward more violence diminishing," says Tom O'Gara. ■

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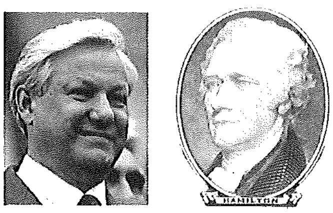
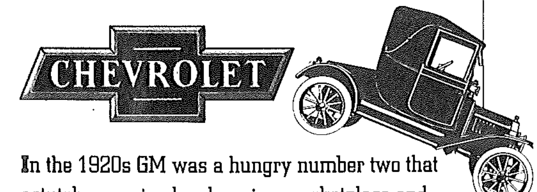


BORIS YELTSIN, MEET ALEXANDER HAMILTON by Jude Wanniski.



In the 1920s GM was a hungry number two that astutely perceived a changing marketplace and rudely knocked number-one auto builder Ford, satisfied and complacent, from its number-one perch. It's uncannily similar to the way the Japanese beat the U.S. auto industry in the '70s and '80s.

HOW GENERAL MOTORS BEAT FORD by J. M. Fenster.

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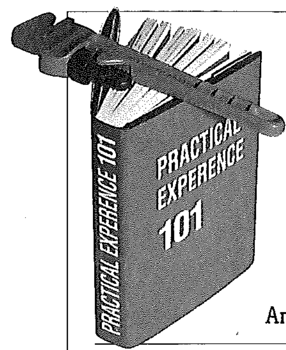
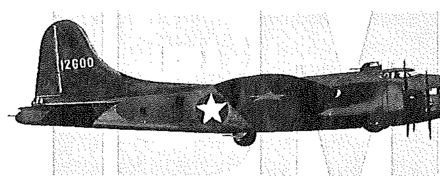


We used to start our managers on the shop floor. Now we start them off in business school. By forgetting much of what we long knew, and divorcing operating and top management, we have put ourselves in severe jeopardy.

WHY BUSINESS HISTORY? An interview with Alfred Chandler.



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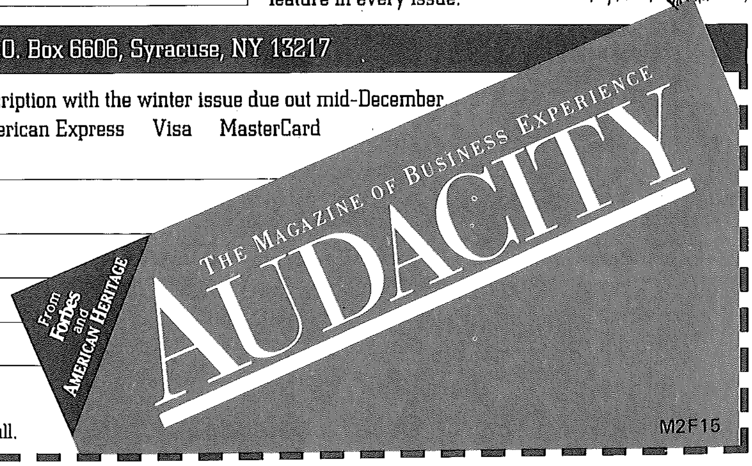


M2F15

 Foreign add $3 per year.

Christopher Carey won the biggest contract he ever had, and it almost sank him. The lessons learned from that have made him a big winner.

Learning curve

By Reed Abelson

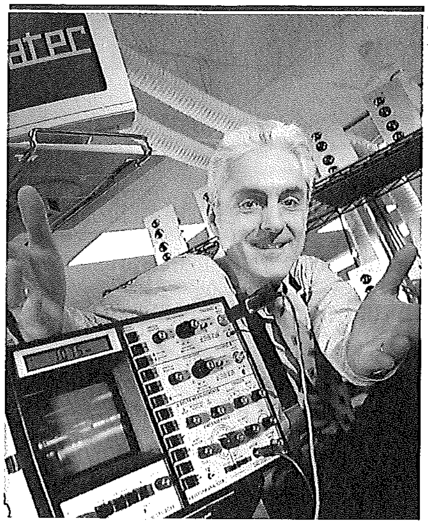
FRESH OUT OF Princeton in 1975 with a degree in architecture, Christopher Carey signed on as a salesman with Datatec, a small Fairfield, N.J. firm that helped retailers wire their stores for computers. Within a year, he had a chance that few 24-year-old hires have: running the whole show.

The little company was losing money, and the owner had decided to bail out. Carey and three other partners—who have since sold out—raised $50,000 in bank loans and bought the firm's assets, which consisted of some inventory and desks, two trucks and tools. Over the next dozen years, Carey quietly built Datatec Industries into a solidly profitable company with $13 million in sales, and virtually no debt. Still in his mid-30s, Carey was already a modestly wealthy man.

One day in 1988 Carey landed a really big contract. It almost sank him.

It was a $5 million job to ready 1,600 McDonald's restaurants throughout the U.S. for a new computer system. It was the biggest client Carey had landed to date. Which was the problem. His 140-person staff simply wasn't up to it. Work crews were constantly being called back to the restaurants to redo sloppy work. The fast-food giant was unhappy with the quality of Datatec's work. Carey, trying to keep it all together, found himself on one flight after another to McDonald's headquarters in Chicago. "I have to say that was a horrible year and a terrible time in my life," says Carey, who at 40 is prematurely gray. "My God," he recalls thinking, "this isn't my dream come true."

It was a nightmare. Carey realized two painful lessons that many small business owners eventually learn, sometimes too late. He was trying to do too much himself; and entrepreneurial enthusiasm doesn't always translate to efficient management.



Gary Spector

Datatec's Christopher Carey
Finally making customers happy.

Carey stopped running Datatec like a one-man show. He started delegating, making sure the employees directly responsible for making the customer happy had the authority to make decisions. No more imposing his views on people down the line. He set up management teams. Customers were asked to evaluate the company's service each quarter, and store managers were asked to grade the crews that installed the equipment. Regular staff meetings were held to review performance and customer feedback.

Carey had learned—and drummed into his associates: Do what the customer wants and don't argue with him; you're serving him, not doing him a favor by being there.

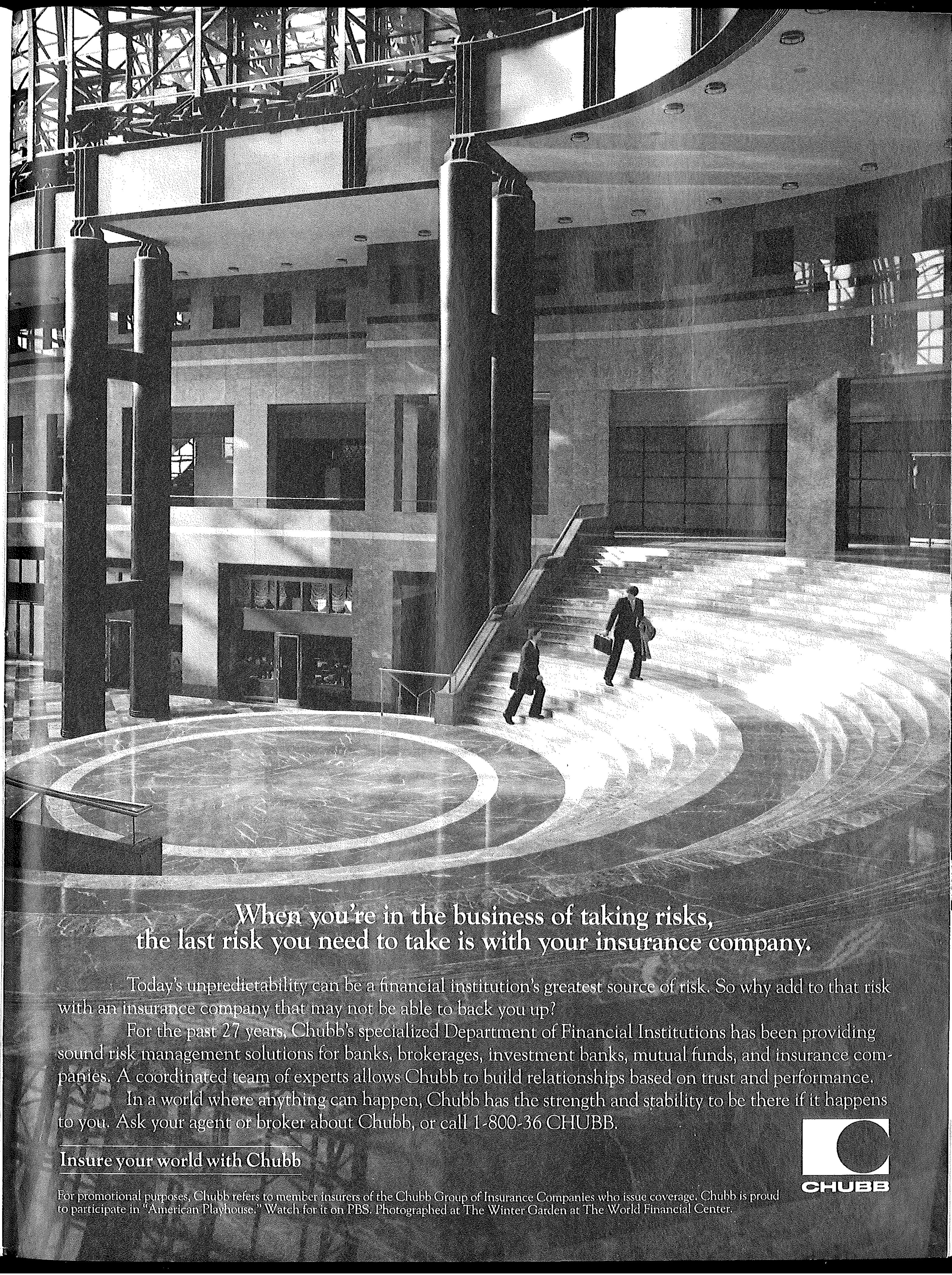
Here's how much Datatec has changed: In October 1991 a Home Depot store manager in New Jersey frantically dialed Datatec's 24-hour help line. His store was mobbed with customers, and half the checkout lines were down. He had notified the manufacturer and the electrical contractor, but neither was much help. Home Depot wasn't a customer of Datatec, but its manager had called out of desperation. Datatec sent a manager who worked through the night. Home Depot is now an $850,000-a-year customer.

Carey's latest project is something called ShopperTrak, an infrared optics system that determines whether a shopper is entering or leaving the store and whether the person is an adult or child.

The traffic data, combined with actual sales figures, help determine a store's "conversion" rate—how many people passing through the door actually buy. Pier 1 Imports and Kmart are both testing the system—which is far more sophisticated as a marketing analysis tool than older methods of counting bodies. "The accuracy is quite phenomenal," says David Carlson, a senior vice president at Troy, Mich.-based Kmart.

The goal, of course, is to increase the conversion rate. If the conversion rate is too low, the store must be doing something wrong. Perhaps it needs to open additional registers or put more salespeople on the floor at any given time. "If we increase our conversion rate 3%, that translates to a 10% improvement in business," says James Tener, senior vice president for operations at Pier 1 Imports, the Fort Worth, Tex.-based retailer.

What's next? Carey is eyeing the Canadian and U.K. markets for ShopperTrak. Datatec now has about 200 clients and visits some 1,600 stores a month. Last year it earned about $40 million in revenues, netting roughly $2 million. Carey still owns it lock, stock and barrel. He concedes he has thought about going public, but right now he's too busy making sure that his customers are happy.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Instead of whining about foreign competition, novice industrialist James Peyton bet his life's savings that he could outsmart it. He won.

Forging ahead

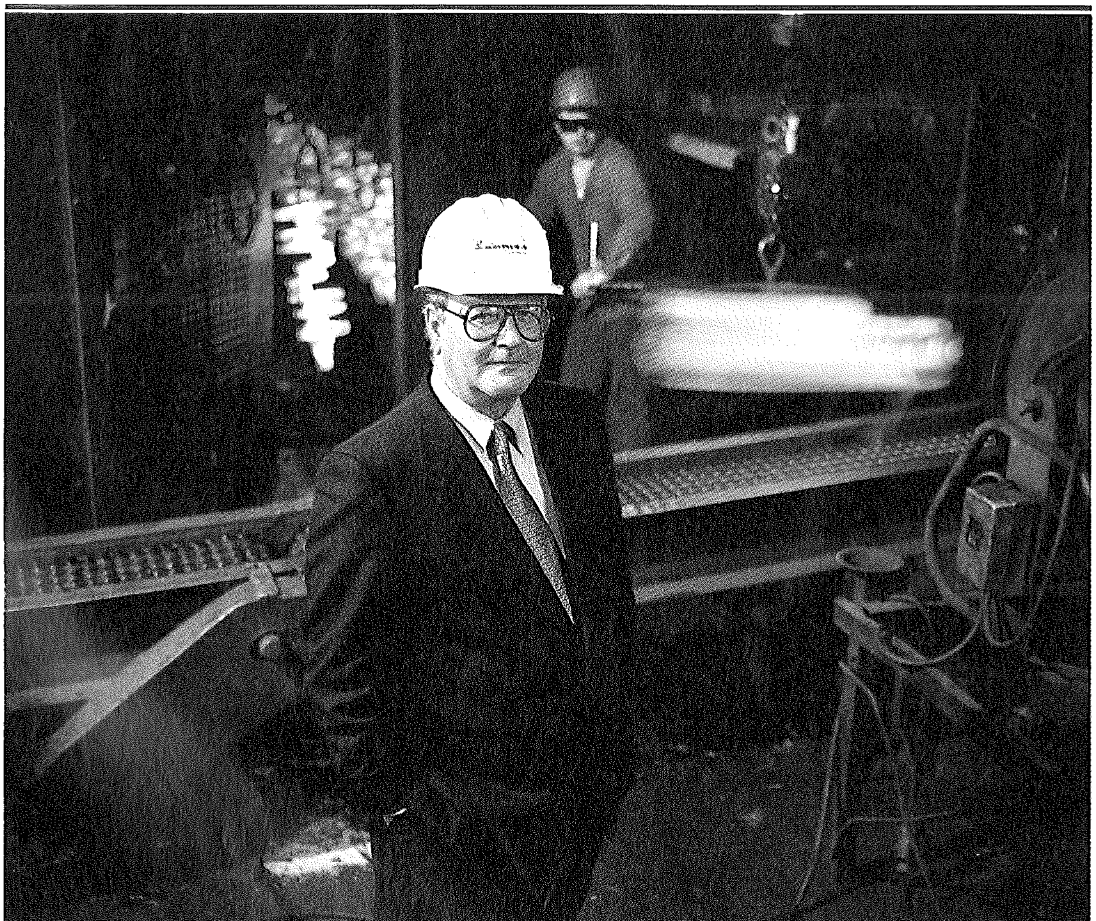
By Carol M. Cropper

THIS IS YET another story about a man who goes against the conventional wisdom—and cashes in by doing so.

In the early 1980s, as the chief financial officer at the Farm Credit Bank of Louisville, James Peyton kept telling his bosses the farm credit system was doomed. "They'd lent all this money out on inflationary values without cash flow to support it," he recalls. "They didn't like me telling them that." Peyton turned out to be right, but by then he was long gone.

The blunt-spoken Jim Peyton and Kentucky's Farm Credit reached in April 1983 what he calls a mutual understanding: "I quit." But what next? Here was a man who began working at age 9 to support his widowed mother and nine siblings and went on to earn an undergraduate business degree from the University of Arizona. His goal was simple, if ambitious. "I wanted to be rich," he says. "But I didn't want to work for anybody else."

Peyton, at 42, decided the best way to get rich was by working with sick businesses. He started researching troubled industries, looking for bargain assets. He focused on forging. Peyton knew nothing about making crankshafts and gears out of raw steel.



Ted Wathen/Quadrant

Louisville Forge owner James Peyton **Building on a dead forge's ashes, he rekindled a flame in American industry that Japanese and German competitors had nearly snuffed out.**

But he knew it was a once proud American industry that had been falling into the hands of more efficient German and Japanese operators. More than 125 American forging companies had failed since 1980. In that, Peyton saw opportunity for a new American supplier. He didn't know what the opportunity would be, but he did know there was "a reason all these people were going broke." Peyton set out to find it and fix it.

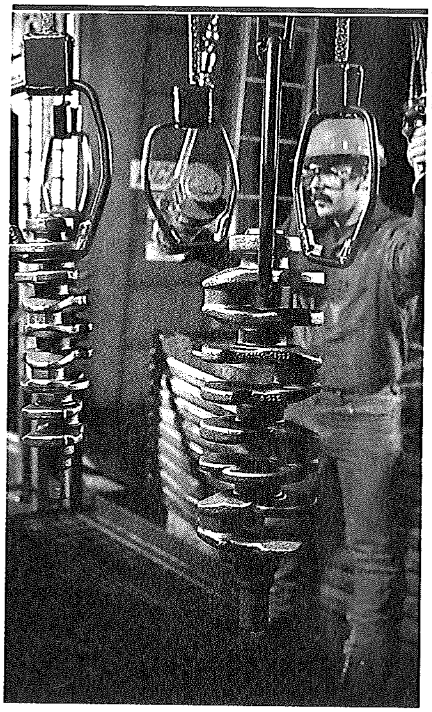
As it turned out, troubled International Harvester Co. (now Navistar International) was desperately trying to unload a forge operation right in Louisville. "They were in deep trouble, so you could deal with them," he says.

Peyton bought the plant and equipment—which had attracted an earlier bid of $35 million—for $9.2 million in April 1985. "It was a fire sale," he recalls. Peyton mortgaged his home and emptied his savings account to raise $500,000. He borrowed $2 million from Louisville's First National Bank. Harvester financed the rest in exchange for a 7% note and gave Peyton a commitment to buy $5 million worth of crankshafts a year for its trucks.

That was enough to get his Louisville Forge & Gear Works Inc. off the ground, and allow it to be profitable in its first year. Peyton didn't have much trouble attracting good managers. There were lots of them who were disgusted with old-line managements that would resist changes and suggestions. Peyton's first hire was Raymond Puhl, who had been president of Transue & Williams Stamping Co. of Alliance, Ohio, and is now Louisville Forge's executive vice president and chief financial officer.

It didn't take Peyton long to realize that union featherbedding and resistance to change was a big part of why American forges were failing. He brought in 230 nonunion hourly workers, most of whom had never worked in a forge and therefore never picked up the industry's sluggish habits. Peyton held monthly meetings to hear their suggestions and gave experienced employees a share of profits. All employees with a minimum of six months at Louisville Forge & Gear Works become eligible to share 5% of the company's operating profits. Over $450,000 was paid out in 1992.

Peyton had analyzed the noncompetitiveness of American forges and traced it to three factors: price, quality and delivery time. He spent $13 million over the past seven years to buy new equipment and to upgrade Harvester's ragtag furnaces; the money came out of cash flow. Among his purchases: a $100,000 computer system with customized software to cut dies automatically instead of by hand.



Ted Wathen/Quadrant

Crankshafts from Louisville Forge headed for a nearby Toyota plant
Snatching a big Japanese customer with better price, quality and reliability.

Peyton instituted a system of quality spot checks to catch errors before an entire run of parts was lost to the scrap heap. Result: Only 1.34% of Louisville Forge's steel winds up as scrap, compared with an industry average of 2.5% to 3%. That difference saves the forge $750,000 a year.

Louisville Forge's technicians make repeated visits to customers' factories to get the forge's parts as close as possible to the size they eventually need to be. That means the customer's machine shop has to do less cutting to make the parts fit. The customer saves work, Louisville Forge saves steel.

Today Peyton's privately held Louisville Forge is the largest U.S.-owned manufacturer of steel crankshafts. Revenues this year should top $50 million, and Peyton figures to net about $5 million from that. Among his biggest customers are Rockwell International and Navistar International Transportation Corp. Peyton is negotiating with Ford to make parts for a Mazda engine that will be assembled in Mexico.

In his biggest coup, Peyton three years ago snagged Toyota's nearby Georgetown, Ky. plant in a competition judged on quality, reliability and price. Louisville Forge makes 230,000 crankshafts a year for Toyota, about 30,000 of which go to Japan. Peyton proudly points to a Toyota performance report posted near a batch of parts at the forge. It gives the number of crankshafts shipped through early December: 206,501. Defects: two. Delivery on time: 100%.

None of this means Peyton can relax. The Germans and the Japanese are circling. In 1991 Krupp Gerlach Crankshaft Co. bought an American forge to establish a beachhead in Illinois. Japan's Sumitomo joined forces with Masco Corp. of Taylor, Mich. to open a forge in Georgetown and is sniffing around the Toyota business. Late last year Krupp snatched away Peyton's biggest customer, Cummins Engine, taking that company's crankshaft business to Brazil.

Meanwhile, Peyton must spend energy, time and money—about $1.7 million in legal fees so far—fighting the local airport authority, which wants to condemn his forge to add a runway. It's a threat that has his foreign competitors gloating.

But Peyton isn't fazed. Now that he is finally a wealthy man—Peyton values his 100% stake in the forge at about $100 million—he simply has another unconventional idea: to go out and buy a steel mill. "I'm a doer," he says. "Risk doesn't bother me." ■

Internet and some innovative software are changing the nature of the library. Instead of being at the end of the block, a book collection will exist in cyberspace.

Good-bye, Dewey decimals

By David C. Churbuck

IT WOULD BE too much to argue that the jobs of the 152,000 librarians in the U.S. are in jeopardy. But it's fair to say that their jobs will change dramatically over the next two decades, courtesy of the Internet computer networking system and new software that controls Wide Area Information Servers, or WAIS.

Internet, a global network of computers formed by the government to connect universities, research labs and military complexes, was until recently largely limited to nonprofit users. But it is now taking on commercial customers (FORBES, *July 8, 1991*), who are finding the system an extremely economical way to gather and trade information. For as little as $1 an hour, a subscriber to Internet can sit at a personal computer in his office, issue a request for information, and have the network route his request to libraries across the globe. The system will retrieve in a matter of seconds a collection of card-catalog citations that would have taken a lot of shoe leather to find in person. How else would a scholar in Chicago find out that "chaos" was touched on in a book written in 1741 in Latin and found in Harvard's library? Or what's in the Australian Defence Force Academy library. If he wants the volume, the researcher can follow up with a request for an interlibrary loan.

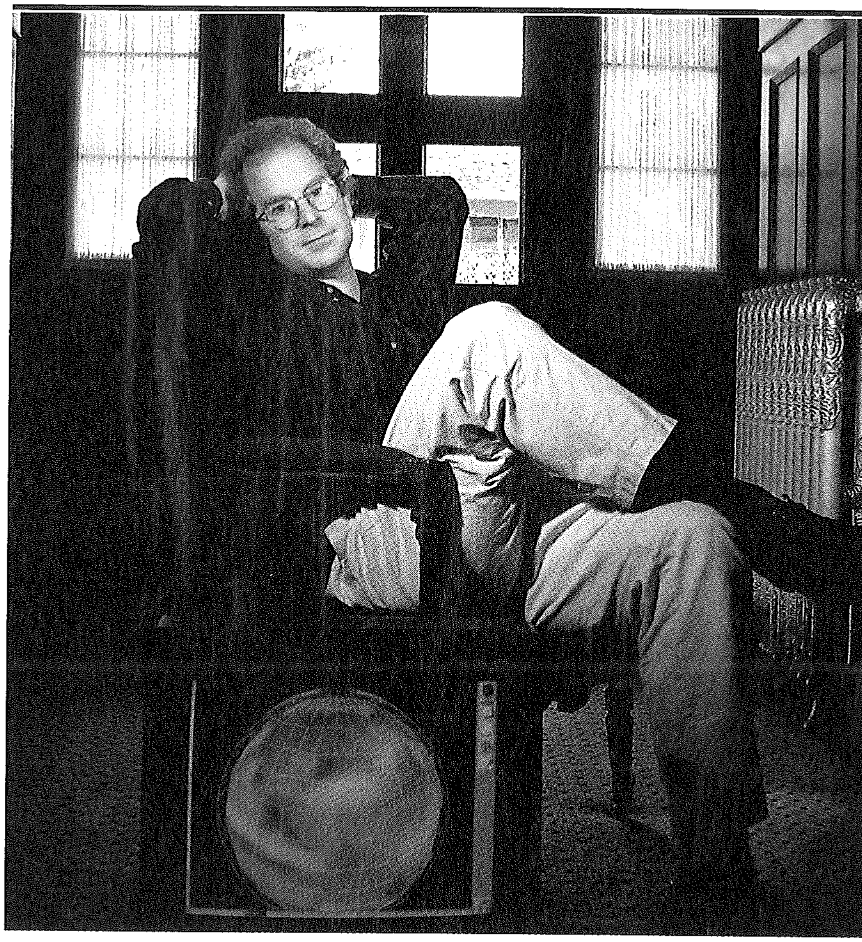
Full-text retrieval, still very limited at this point, is around the corner. When it comes, the local library as we know it all but disappears. In lieu of librarians we will have programmers and database experts.

One of the fathers of the Wide Area Information Servers concept is Brewster Kahle, who developed programs for searching databases when he worked at Thinking Machines Corp., the Cambridge, Mass. manufacturer of supercomputers. Thinking Machines is primarily interested in developing a market for its hardware, whose parallel processors are ideally suited to massive text searches. Kahle's interest is in the software.

"People want to be able to pose a question to the net[work] and not care where the answer comes from," says Kahle, 33, who recently left Thinking Machines to form WAIS Inc., in Menlo Park, Calif. Kahle's firm helps corporations and publishers set up electronic versions of copyrighted and public domain material and then make it accessible to users who are willing to pay for each download.

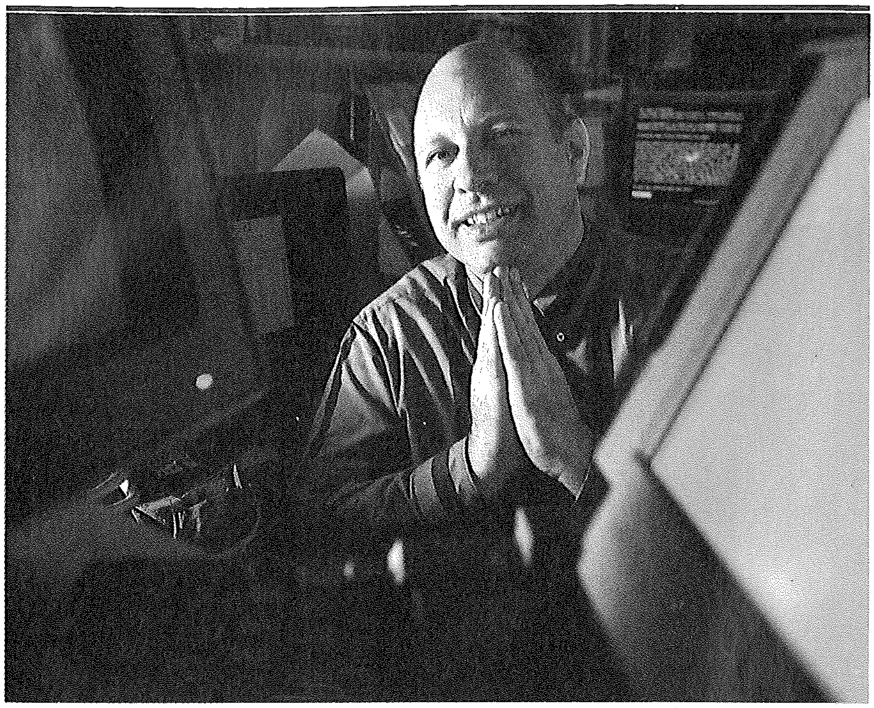
Kahle's software first paws through

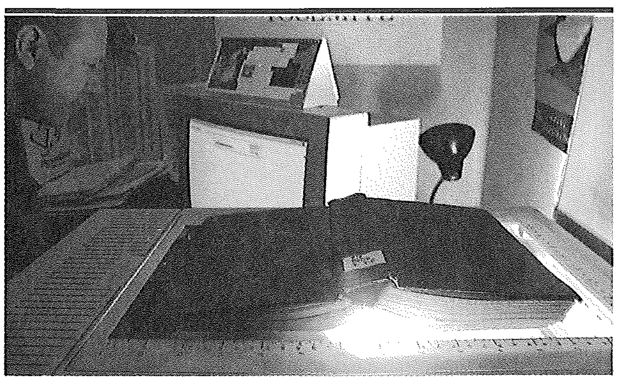
WAIS Inc. founder Brewster Kahle
Building the electronic library of the future.



Acey Harper

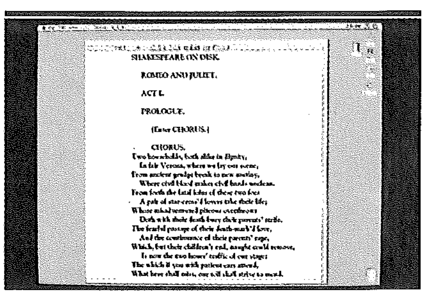
Photographs by Michael L. Abramson





Project Gutenberg founder Michael Hart; book scanning

Filling the shelves.



the raw text, indexing it to speed up later searches. Users can then submit plain-English queries. Ask for songs with the words "eyeball" and "toe jam," and it will come up with the Beatles' "Come Together." The system learns from trial and error, since the user can tell the computer which of the retrieved documents was closest to what he was looking for.

"WAIS is like a research librarian who watches you read through a stack of information, taking notes on what you looked at first and set aside for future reference, and what information you threw away," explains Kahle. You can use WAIS to search a database on your own computer, but the software is optimized to handle the complexities of searches through physically distant databases.

Programmers at the University of Minnesota have taken WAIS a step further. To get information from a WAIS, you have to know exactly where that information is—which server has, say, a collection of song lyrics. The new software, called Gopher, makes it easier to navigate through the network. Richard Wiggins, Gopher coordinator at Michigan State University in East Lansing, Mich., explains the difference between WAIS and Gopher: "WAIS is for direct searches. Gopher is a browsing tool." Enhancements to Gopher aim at Kahle's ideal—a query about the Beatles is answered with simultaneous searches through all the card catalogs on the network.

More libraries are joining the two-year-old Gopher system all the time, but the best is yet to come, including the 22-million-volume Library of Congress.

As with any new technology, some librarians are finding it hard to adapt. Says Wiggins: "In general terms, this technology is of interest to libraries, but it is frightening at the same time, setting off a struggle between academics who want knowledge spread around and librarians who want to control it."

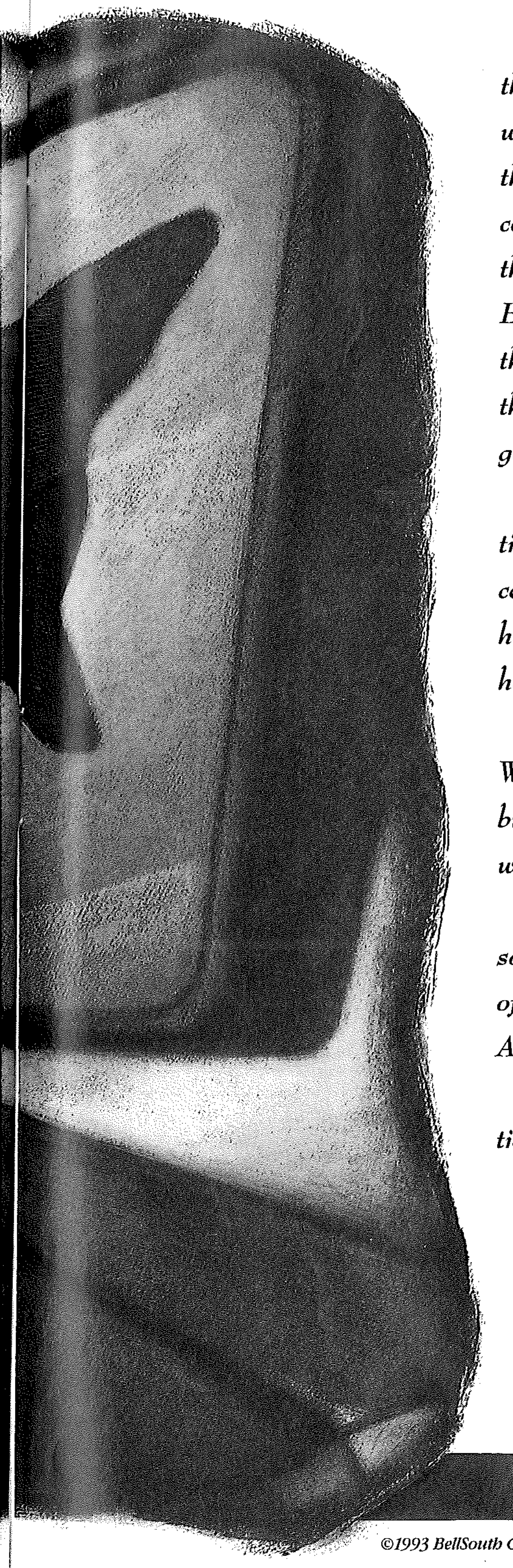
Wide area information fanatics dream of an interlibrary loan system on a grand scale, in which only one copy of each book or magazine is in the system at all. That one copy could be used by many people at the same time and it would never be lost or overdue. Also, to the consternation of publishers thinking about royalties, it could be easily duplicated.

For this system of the future to become real, existing libraries of printed books will have to be digitized. That's the objective of Project Gutenberg, the creation of Michael Hart, professor of electronic text at Illinois Benedictine College in Lisle, Ill. If Kahle is building the shelves for the electronic library of the future, Hart is filling them. Gutenberg transcribes books, mostly in the public domain, for free digital distribution, whether via floppies or Internet.

For most of the 22 years that Hart has been at work on Gutenberg, digitizing has meant the slow and arduous retyping of the classics. Now, however, all Hart has to do is shred the binding off a book and feed the sheets into a scanner. Gutenberg has 50 titles on-line so far and expects to have 10,000 ready by the year 2001. That's nothing next to what the Library of Congress could crank out if it got serious about digitizing its collection, a project just getting under way. And if the programmers can solve some knotty problems involving pay-per-view and copying, there's no reason that newly published books cannot go on the system, too.

Once This National Hamburger Chain Saw What Our Services Co

es Could Do For Them Regionally, They Only Had One Question.



When a hamburger giant gets an appetite for increasing business at thousands of franchises, you know they're not thinking small. That's why when this particular fast food chain went looking for a way to streamline their telecommunications, they looked for the telecommunications company that had the biggest ideas. BellSouth. Then they asked, could they get them to go? It was a big order. But we were ready.

Could They Get Them To Go?

First, we helped set up a voice-mail system that allowed them to tie their locations together across the country. Then, we coordinated cellular service for their field managers — nationwide. So they could have a single point of contact for sales and service. For most, it would have been a special order. For us, it was business as usual.

They came to BellSouth because we're more than one company. We're a family of communications companies capable of providing your business with the same combination of wireless and wireline solutions we provided for them.

From paging, cellular, mobile data and information services, to sophisticated telecommunications networks, BellSouth has the depth of resources required to meet your communications challenges today. And tomorrow.

Want a taste of what BellSouth can do for you? For more information, call your BellSouth Representative, or 1-800-787-BELL.

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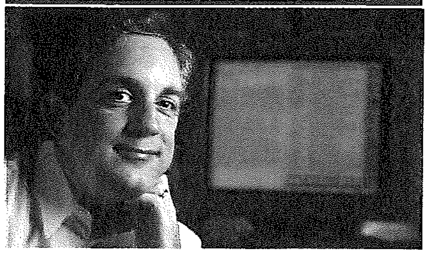
COMMENTARY BY MITCHELL KAPOR



Mitchell Kapor is the founder of Lotus Development Corp. and the president of the Electronic Frontier Foundation. Mitch Ratcliffe, editor-at-large for MacWEEK, provided research assistance for this column.

IT DOESN'T TAKE MUCH to persuade Congress to jack up the penalties for white-collar crime, and last fall's amendments to the Copyright Act were a prime example. With a little prodding from the Software Publishers Association, legislators made a felony of possession of ten unauthorized copies of a program, collectively valued at as little as $2,500. The new law is a powerful bargaining chip for an industry that has learned to enforce its property rights through intimidation. A little too powerful, I'll wager. Under the new law, just about any computer department manager could be charged as a felon.

There's no doubt that software companies need help enforcing their property rights against brazen counterfeiting schemes, as a recent action brought by Microsoft shows. Its civil suit against Taiwanese defendants alleges that hundreds of thousands of counterfeit copies of the MS-DOS operating system were sold to unsuspecting customers. Armed with seizure orders, attorneys for Microsoft staged elaborate raids on secret warehouses in southern California, carting off truckloads of contraband. Use of the new criminal provisions of the copyright law makes sense in an extreme situation such as this.

But should it be a felony to make ten unauthorized copies of a program? In public speeches on this topic, I routinely ask members of the audience how many of them will stand up to declare they have no unauthorized copies on their hard disks. Only a tiny minority are willing to stand up and be counted as without sin. This suggests to me that, under the new law, any manager with a handful or more of employees could be prosecuted and sent to jail.

Software producers, of course, have to protect themselves against more than the counterfeiters. The software association estimates that its members lose between $1 billion and $2 billion a year in revenue from customers who buy fewer copies of business software than they should.

At Lotus, we tried to solve this problem by adopting technical measures to restrict the copying of files. As I learned to my chagrin, this approach had the unacceptable consequence of also restricting legitimate uses by paying customers. Nowadays very few software producers use copy protection devices. They're too likely to be broken by serious hackers and too likely to alienate innocent users. As a simple technical matter, there is no barrier today to anyone walking off with a $500 product in a shirt pocket, or to a corporate software customer that wants to use more copies than it is willing to pay for.

But the solution to this problem is not a rigid prohibition on copying. Even in the overwhelming majority of honest companies, including many with stringent internal policies, employees routinely make copies of their applications for use on portable and home computers, temporary copies for a co-worker, multiple back-up copies and the like. Unauthorized copies proliferate. Careful lines must be drawn, dividing software duplication into three different grades of behavior: totally innocent copying, unfair use that might give rise to a lawsuit, and criminal piracy. The new antipiracy law fails to make these distinctions.

The software association claims it has no intention to use the criminal law to enforce essentially civil claims against customers who make and use multiple copies. "I don't need to call the FBI to beat on corporations," says Kenneth Wasch, the association's executive director. "There's absolutely no intention of criminalizing the inadvertent copier in a corporation. We have a very adequate civil remedy." By its own accounting, Wasch's group has done very well in civil court.

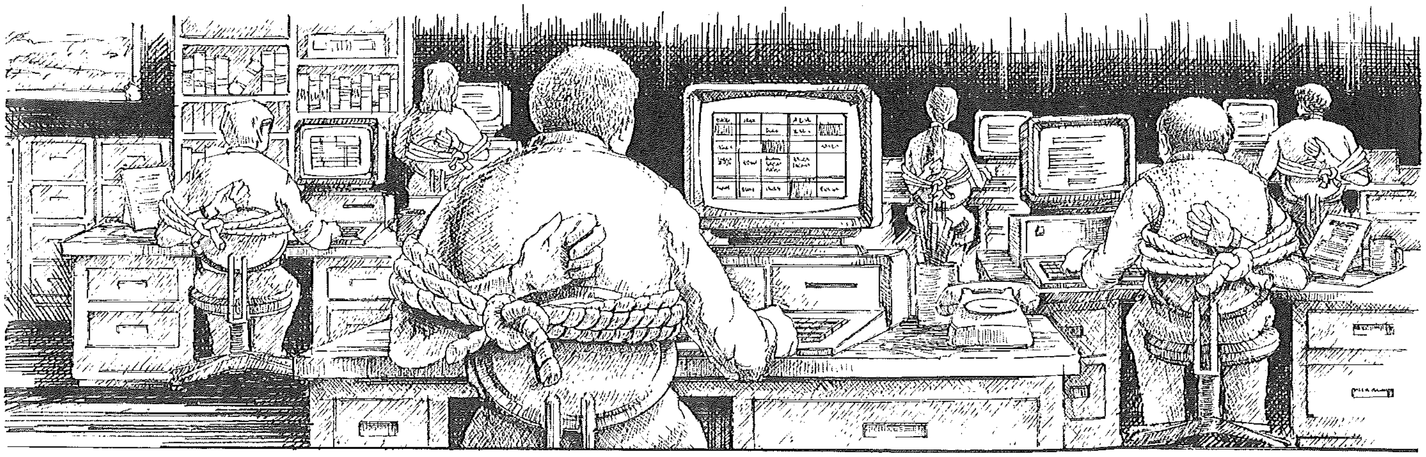
Nonetheless, with these stiff new provisions in place, I can't imagine that sooner or later the felony criminal provisions won't be used, in practice or as threat, against less than obviously flagrant violators. Here's one scenario: The software association will knock politely and ask to review XYZ Corp.'s computers for illegal copies. If XYZ refuses to allow the audit, the enforcers can now do more than file a civil action. They can threaten to call in the Department of Justice for a criminal investigation.

This law is simply prone to abuse. It won't stop piracy, nor will it contribute to a new ethic that respects the hard work and research dollars put into application software.

Software vendors could take one step in the right direction by rewriting their license agreements to be more realistic. Most licenses don't permit a user to install the same copy of a product twice under any circumstances, except to make a backup. However, a few companies permit customers to make multiple installations of a single copy of software as long as only one copy is in use at any time.

With more executives using a desktop computer in the office and a notebook computer on the road, broadening the terms of acceptable use just represents common sense. It would also go a long way toward easing tensions with customers who find themselves uncomfortable at the prospect of being branded as felons.

We live in a difficult era in which, as Stewart Brand puts it, information wants to be free, yet it also wants to be expensive. Until both vendors and users sincerely acknowledge this paradox, efforts to reduce piracy are likely to do as much to foster conflict and discomfort for legitimate users as they do to benefit software producers. ■

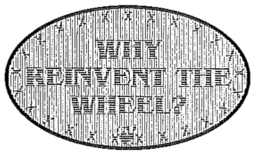


Are your PCs holding you back?

Surprisingly, over 80% of PCs in American industry are operating at a fraction of their capacity. They're performing just one task at a time; requiring users to work in an unnatural fashion.

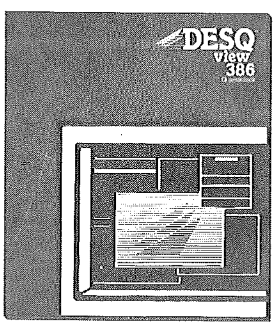
And that means the workers using them are operating at less than their peak productivity. These days, American business can't afford that.

While other software companies have decided the solution is to change the way 60 million users work, we started from the premise that a 'productivity increase' that required a major investment of time and money was an oxymoron.



Our motto.

For instance, DESQview, our multitasking windowing environment allows users to run several of their favorite programs side-by-side, saving time and making the process of working more natural and fluid. Microsoft Windows does many of the same things, but it does so by putting an enormous burden on the computer itself. Many users are forced to replace most of their hardware and much of their software just to use it. That's clearly counter-productive. Seriously. How many minutes a year would a user need to save to pay back an investment of $1,500 -$2,200 in new hardware and software?



DESQview multitasks and windows programs on the PC: graphics or text, DOS or Microsoft Windows—side-by-side.

DESQview sells for under $200 and pays for itself quickly.

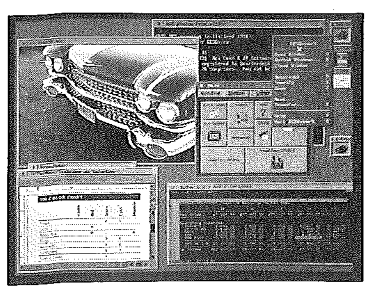
Memory limits are another weakness in many PCs. QEMM-386 makes virtually all the computer's memory available to productivity programs while allowing room for network software, TSRs and new utilities like CD-ROM drivers. Microsoft DOS 5 does some of the same things, but less effectively.

Our QEMM works with and improves MS-Windows and every DOS from 3.0 to 5.0. It's the best selling software utility in the world.

QEMM has won more awards than all other memory managers put together.

Our new DESQview/X smoothly brings PCs together with high-end workstations under the X-Windows standard. You can stop using PCs to do things they're not good at. Choose the best computer for each task and run it from your own PC.

We think our approach is more sensible. Millions of users apparently do too. We simply add productivity to the computers you already have. Perhaps you should look into Quarterdeck products for your company's PCs.



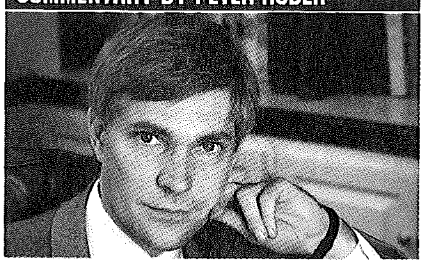
DESQview/X is a new breakthrough that allows computers throughout your enterprise to work together smoothly.

Quarterdeck

For more information, contact Quarterdeck at (800) 582-7486, Ext. 7F1. Or see your software dealer:

Microsoft and the trustbusters

COMMENTARY BY PETER HUBER



Peter Huber, a senior fellow of the Manhattan Institute, is the author of *Galileo's Revenge: Junk Science in the Courtroom* (Basic Books).

SO NOW it's Microsoft that supposedly has a stranglehold on the computer industry. Specifically, Microsoft stands accused of including "undocumented" features in its Windows software, for the special advantage of its own, in-house developers of applications like word processors.

The charges are familiar. Some nefarious entrepreneur has sold millions of excellent widgets—so many that a slew of outsiders now provide gizmos to plug into, connect with, sit atop, or otherwise enhance your basic widget. Enter federal trustbusters, to make sure the Widget King doesn't leverage his market power to the disadvantage of gizmo peddlers.

For "widget" and "gizmo," substitute almost anything you like—you'll find it in the antitrust case books. Salt grinders and salt. Cars and dashboard radios. Cameras and film. Phone companies today are said to threaten the public welfare if they build a handset or supply voice mail alongside basic phone service. Microsoft is in trouble because it sells operating systems, like Windows, and also applications, like spreadsheets.

The standard lawyer's response when a company like Microsoft is deemed too successful is to insert a wall of—you guessed it—lawyers between the widgets and gizmos. However they dress it up, the lawyers now stalking Microsoft will try somehow to segregate "basic" operating systems from fancy applications.

But where exactly should operating systems end and applications begin? If the Microsoft police want apartheid of any kind, they will have to answer that fundamental question. Their objective, after all, is to prevent one kind of software developer from getting too cozy with another.

The experience with line-drawing of this kind in the telephone industry is as dismal as it is instructive. In the 1920s the great enhancement in telephony was the dial telephone, a remarkably high-tech advance over banks of human operators. Today one can buy handsets that dial numbers automatically in response to spoken commands. Similar capabilities will soon be lodged in the network: Callers will once again be able to pick up the phone, speak a name, and be connected. Yet over several decades, the question of whether telephone companies should be permitted to install machines as smart as the human operators of the 1920s has consumed hundreds of millions of lawyer and lobbyist dollars. In the end, machine intelligence will of course come to the network anyway; the only question is how long the matter will be debated, and how rich the debaters will grow in the meanwhile.

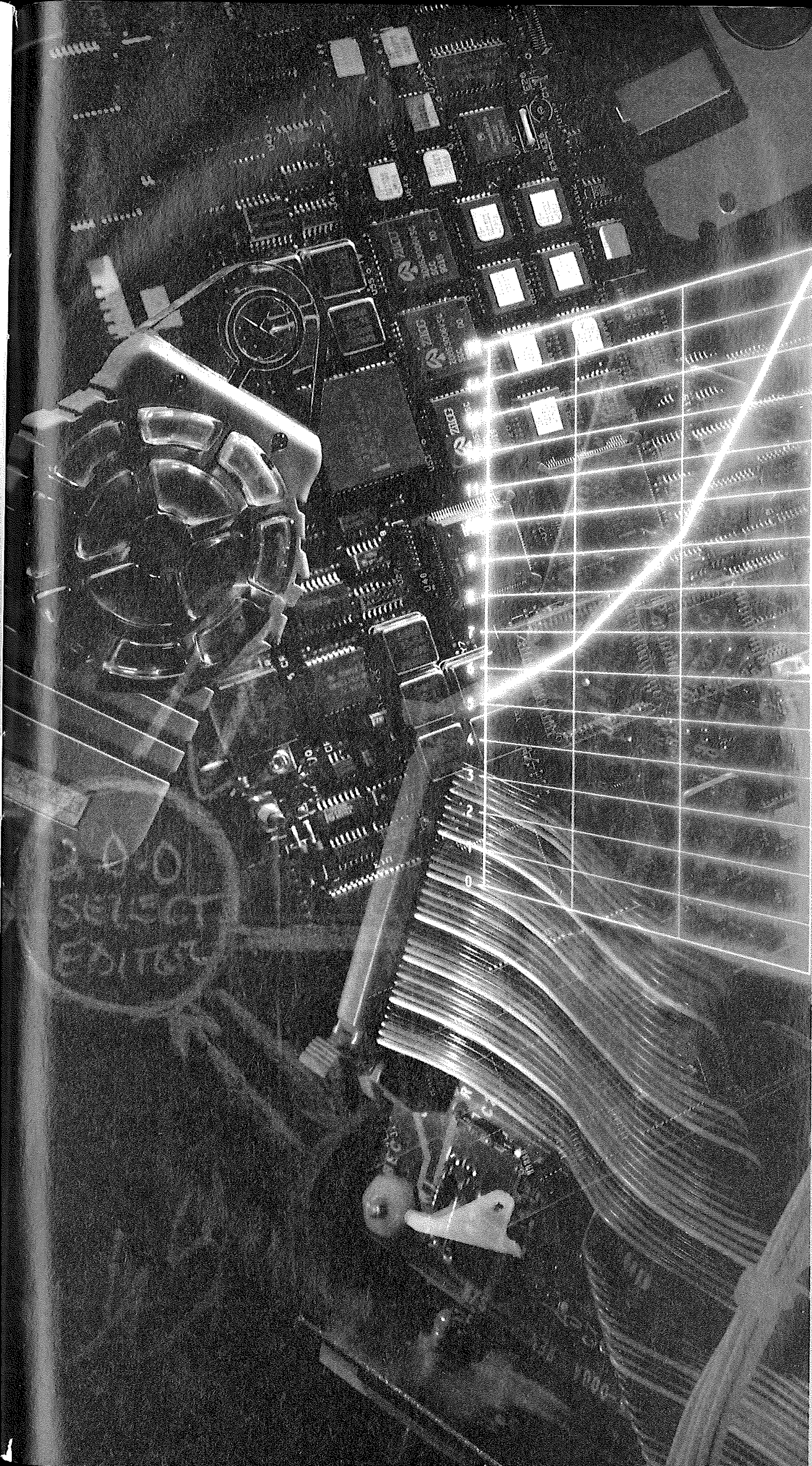
Microsoft stands accused of sneaking things into its software that shouldn't be there. Unleash the lawyers, and Microsoft will soon be forced to leave out things that should be. Today, for example, relational database software is called an "application." But everything in a computer probably should be stored in a relational database of some kind, and if so, today's databases will gradually be swallowed into tomorrow's operating systems. In time, the same may well happen to keyboard macros, printer drivers, modem capabilities, compression algorithms, you name it. Technically speaking, Windows itself is a gizmo, not a widget—it runs atop MS-DOS, like other applications. But Windows has been so successful that it has come to seem "basic."

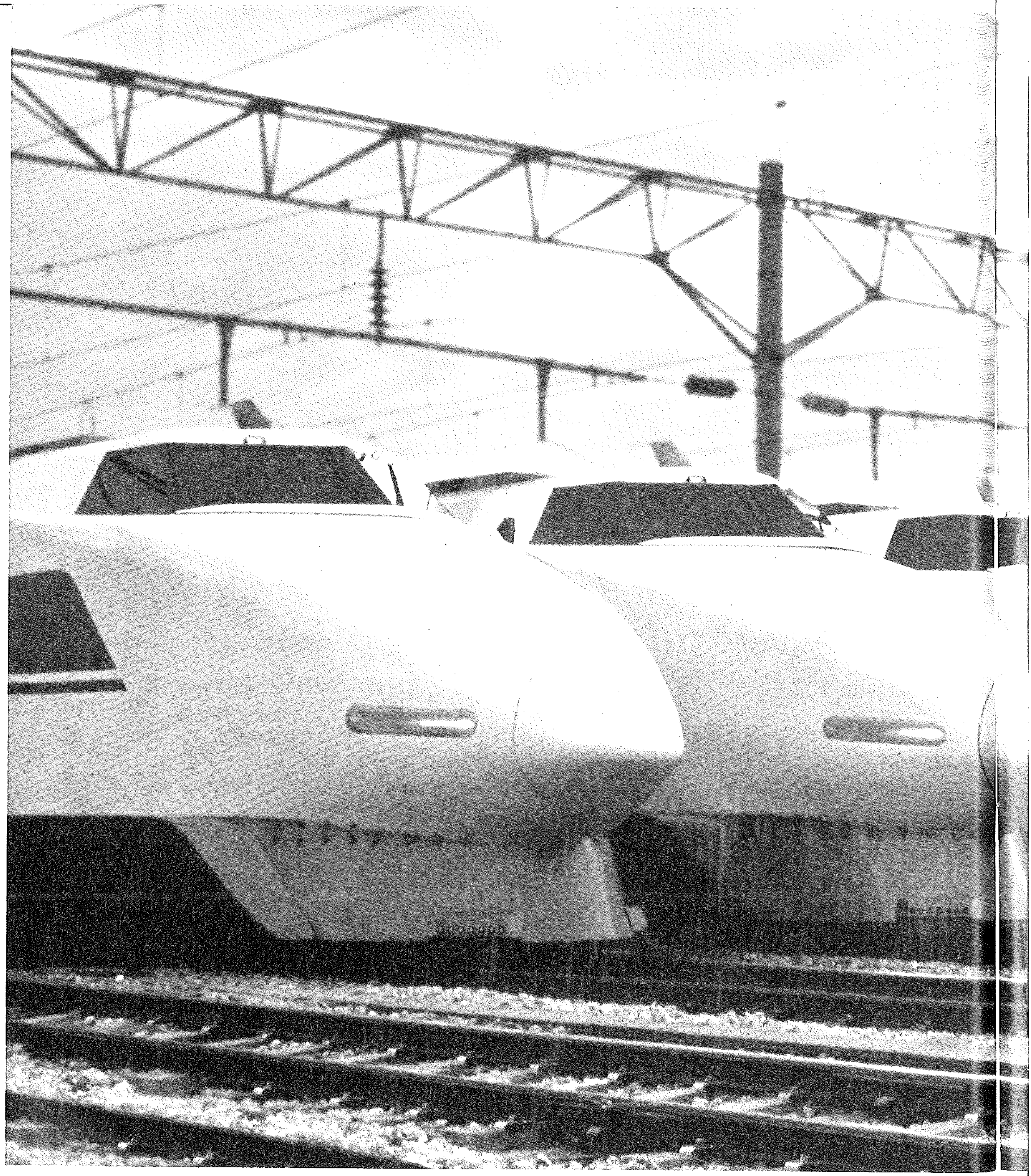
The important point, however, isn't that operating systems must inevitably consume everything else. It's that the very thought of lawyers trying to police software is revolting. When enhancements, peripherals, applications, smarts, what-have-you are really good, they always migrate down the path from gizmo, to widget, to basic necessity. That's not a conspiracy, it's progress.

Microsoft took a huge financial risk with Windows at the outset, and began writing Windows-based applications when lots of outsiders didn't want to waste resources on such an obvious loser. Yet no matter how much software Microsoft writes itself, Windows will thrive only if thousands of independent outsiders continue writing compatible software. That fact provides far more protection against hanky-panky at Microsoft than any array of lawyers will ever deliver. What the feds should do here is stand aside, and let the software market work things out.

If history is any guide, the unfettered market will perform better without federal help than with it. Huge and powerful Microsoft is seen, by the lawyers, to be squashing small and vulnerable IBM (owner of the competing operating system OS/2) and AT&T (creator of the competing Unix). Both OS/2 and Unix might be even more robust today, but for the fact that the energies of their creators were focused elsewhere when Microsoft's DOS slipped into the market around 1980. At that time AT&T was rigidly quarantined from the computer business, because (lawyers said) AT&T was bound to swallow everything if allowed even the tiniest bite. Meanwhile, IBM was defending itself against an unimaginably expensive, paper-clogged antitrust suit, brought against it by the federal government. IBM, you see, had a stranglehold on the computer industry.

And what do we find? Without an antitrust judge in sight, yesterday's indicted strangler now stands cringing on the gallows of the market. ■





WE WERE DOING BUSINESS IN THE PACIFIC RIM WHEN PEOPLE TRAVELED BY RICKSHAW. *The AIG Companies have been doing business in the Asia/Pacific region for over 70 years. In fact, we began providing insurance in Shanghai in 1919, and our network has now grown to include virtually every major economy you may do business in worldwide.*

With the proliferation of stocks, bonds and derivatives, many daily newspapers don't have space to quote them all. But there are reasonably priced alternatives.

Dial-a-quote

By Brigid McMenamin

EVERY YEAR there are more stocks, bonds, options, mutual funds and other investments. With newspaper space available for listings tight, where is the investor to turn for quotes? *USA Today* publishes only 1,500 of the most actively traded New York Stock Exchange stocks, out of a total 2,500 issues listed. Last December the *Wall Street Journal* reduced the pages listing options, from two or three every day to one. New York's *Newsday* recently polled its readers to find out which quotes they really want.

Some newspapers are supplementing their tables with telephone quote services, which save newsprint and give publishers another source of income, either through customer fees or advertising. The Minneapolis-St. Paul *Star Tribune,* for example, freed up an editorial page, and saved maybe $500,000 last year, by trimming 4,000 stocks from its tables. But readers can still get those quotes free by telephone. Every day about 15,000 call. Some 125,000 callers use the *Atlanta Journal-Constitution*'s free Stockphone service each week.

Dow Jones & Co., publisher of the *Wall Street Journal,* has four separate services to provide investors with quotes and financial information.

Our table lists 18 services that provide stock quotes and other financial news and data. Some require only a telephone, others a computer. A few operate over FM radio frequencies, for which you need a special radio receiver. One operates over cable TV lines. Some of these services also allow you to fetch and manipulate historical price data, to buy and sell securities and to get prompt confirmations.

Which system is best for you depends on how much information you need and how much you want to pay.

If you do a fair amount of trading, discount brokerage firms offer some of the most attractive deals. Charles Schwab & Co. offers TeleBroker, simple to operate and requiring only a phone. Dial a toll-free number, punch in your account number and password and you can get real-time market quotes and financial information, and make trades. The information service is free to Schwab customers.

What if you are not a very active trader, or don't want to commit yourself to one broker? If you have a personal computer, you can get quotes and a wide range of financial information from services like CompuServe, America Online, Dow Jones, GEnie and the Prodigy Service. The basic cost for these services is as little as $5 per month—less than you'd pay for most newspapers. But try different services for a while. Many vendors offer low-cost or even free trials. It pays to shop around. No need to pay for more than you use. ■

Keeping abreast of the market

Even for the small investor, up-to-the-minute stock market quotes are easily and fairly cheaply accessible these days—by phone, computer, radio, TV and cable TV. Below, some of the most popular market data services tailored for individual investors.

Dow Jones & Co.	
DowPhone 800-345-NEWS	*Services:* Real-time quotes on stocks, mutual funds, commodities, options and indexes. Also business and financial news, technical opinions and investment analysis. *Hardware:* Touch-tone phone, with which you punch in stock symbols or names of companies. *Cost:* $15 to sign up, $1.25 per minute if you call 800-222-0248, or 95 cents per minute if you call 212-285-8400 or 609-452-0777.
JournalPhone 900-JOURNAL	*Services:* Stock quotes updated every 15 minutes; mutual fund quotes, market updates and news on 250 selected companies. *Hardware:* Touch-tone phone. *Cost:* 95 cents per minute.

Dow Jones News/Retrieval 800-522-3567	*Services:* 15-minute delay on stock quotes, articles from periodicals; newswire reports, industry and company information, statistics and commentary. *Hardware:* IBM or IBM-compatible or Mac computer, plus modem. *Cost:* \$29.95 startup, which includes 3 free hours of use; \$18 per year. Thereafter you pay per minute and per information unit. To get real-time stock quotes, individual investors pay additional fees ranging from \$3.25 to \$11 monthly, per stock market exchange.
After Hours/Flat Fee Plan 609-520-4649	*Services:* From 8:01 pm to 6:00 am local time you can get news, closing quotes, and forecasts and analyses. *Hardware:* IBM-compatible or Mac computer, plus modem. *Cost:* \$25 per month for news and quotes only, to \$49.95 per month all-inclusive.
Brokers	
Fidelity On-line Xpress (FOX) 800-544-7272	*Services:* Real-time stock quotes, ability to trade and get instant confirmation; options include Dow Jones News/Retrieval and other information services. *Hardware:* IBM-compatible computer and modem. *Cost:* \$119.95 to sign up (special offer now, \$89.95). Customers get 100 free calls (up to 50 quotes per call) for every trade placed through FOX.
PC Financial Network (part of Donaldson, Lufkin & Jenrette)	*Services:* Real-time stock quotes, ability to trade securities, including options; other financial information supplied through Prodigy. *Hardware:* IBM-compatible or Mac, plus modem. *Cost:* no sign-up fees. Available to Prodigy users only, on-line sign-up.
Charles Schwab & Co. TeleBroker 800-272-4922	*Services:* Securities trading, real-time quotes on stocks, options, mutual funds, warrants, units, rights and market indicators. *Hardware:* Touch-tone phone. *Cost:* Free to Schwab customers.
Schwab Equalizer 800-648-4248	*Services:* Real-time quotes, on-line investment advice, current and historical investment news, and ability to trade. *Hardware:* IBM-compatible and modem. *Cost:* \$69 for Equalizer software. Includes 60 minutes of services like Dow Jones News/Retrieval. Note: Schwab brokerage services are also available to customers of GEnie (see below).
Data Services	
America Online 800-827-6364	*Services:* 20-minute delay on quotes, plus range of financial and other information. Ability to trade via Quick & Reilly. *Hardware:* IBM-compatible or Mac, and modem. *Cost:* \$7.95 per month, 10 cents per minute after the first 2 hours.
CompuServe 800-848-8199	*Services:* 15-minute delay on stocks and options. Also closing prices on mutual funds, dozens of other services. Ability to trade via discounters E*TRADE; Quick & Reilly; Spear, Rees & Co. *Hardware:* IBM-compatible or Mac, and modem. *Cost:* \$7.95 a month, plus \$49.95 to sign up, which includes 1 month service and \$25 credit toward access charges of \$12.80 to \$22.80 per hour, depending on your modem speed. Real-time quotes available for \$30 additional per month.
GEnie 800-638-9636	*Services:* 15-minute delay on quotes, ability to trade, numerous additional services. Real-time quotes available free for Schwab customers (see above). *Hardware:* IBM-compatible or Mac, plus modem. *Cost:* \$4.95 a month, plus access charges. In prime time (8 am to 6 pm Monday to Friday) \$12.50 per hour; off-prime hours, basic service is free.
The Prodigy Service 800-PRODIGY	*Services:* 15-minute delay on quotes, ability to trade via PC Financial Network (see above), numerous additional services. *Hardware:* IBM-compatible or Mac, and modem. *Cost:* \$49.95 for startup, including first month; thereafter \$14.95 per month; technical stock and fund database, additional \$14.95 per month.
Quote services	
Quotron Systems, Inc. RemoteAdvantage 212-898-7000	*Services:* 15-minute delay on quotes from over 60 exchanges, mutual fund prices, various additional services. *Hardware:* IBM-compatible (at least 386 model) plus modem. *Cost:* Average \$400 a month. Real-time quotes available for exchange fees.
QuotDial 212-898-7000	*Services:* 15-minute delay on quotes; other financial data. *Hardware:* IBM-compatible computer (386 or better) with modem. *Cost:* \$50 startup, \$10 a month, plus \$30 per hour, or \$175 a month, plus \$10 to \$17 per hour, depending on location; real-time quotes available for exchange fees.
PC Quote 800-225-5657	*Services:* Real-time quotes, news, technical analysis, other services. *Hardware:* IBM-compatible (386 or better). *Cost:* \$750 installation fee, \$395 per month, plus exchange fees.
Radio	
QuoTrek 800-367-4670	*Services:* Real-time quotes on stocks, options, futures and funds. *Hardware:* Special radio receiver. *Cost:* \$70 monthly for one equity exchange, \$10 to \$30 for each additional exchange, plus exchange fees.
Telemet America 800-368-2078	*Services:* 15-minute delay on quotes; additional financial data. *Hardware:* Pocket Quote Pro receiver, or IBM-compatible computer. *Cost:* \$395 for receiver supplied by Telemet, plus \$35 monthly; computer users pay \$99 startup fee, plus \$37.50 per month; real-time quotes available for exchange fees plus \$10 per month.
Cable TV	
Signal 800-367-4670	*Services:* Real-time or 15-minute time-delayed quotes to your PC via cable TV hookup, FM radio signal or satellite. *Hardware:* IBM-compatible computer or Mac, plus cable connector (\$325 for time-delayed, or \$695 for real-time) or radio receiver (\$595, real-time only), supplied by Signal. *Cost:* \$125 startup, plus \$160 monthly base fee; \$20 to \$30 for each exchange, plus exchange fees for real-time.

With a metal detector, some old maps and gumption, you, too, can build a collection of Civil War artifacts.

Snakes, ticks and Dixie treasure

By Christie Brown


Ann States/SABA

Steve Mullinax with Rebel flag, rifle and other memorabilia

The North won the war; the South has won collectors' wallets.

THE 800,000 Confederate and 1.6 million Union soldiers left a lot of gear behind them in the course of America's bloodiest war, in which almost 620,000 men perished. So much, in fact, that hunting for Civil War artifacts is still an active and profitable hobby that continues to feed the nearly insatiable hunger of collectors.

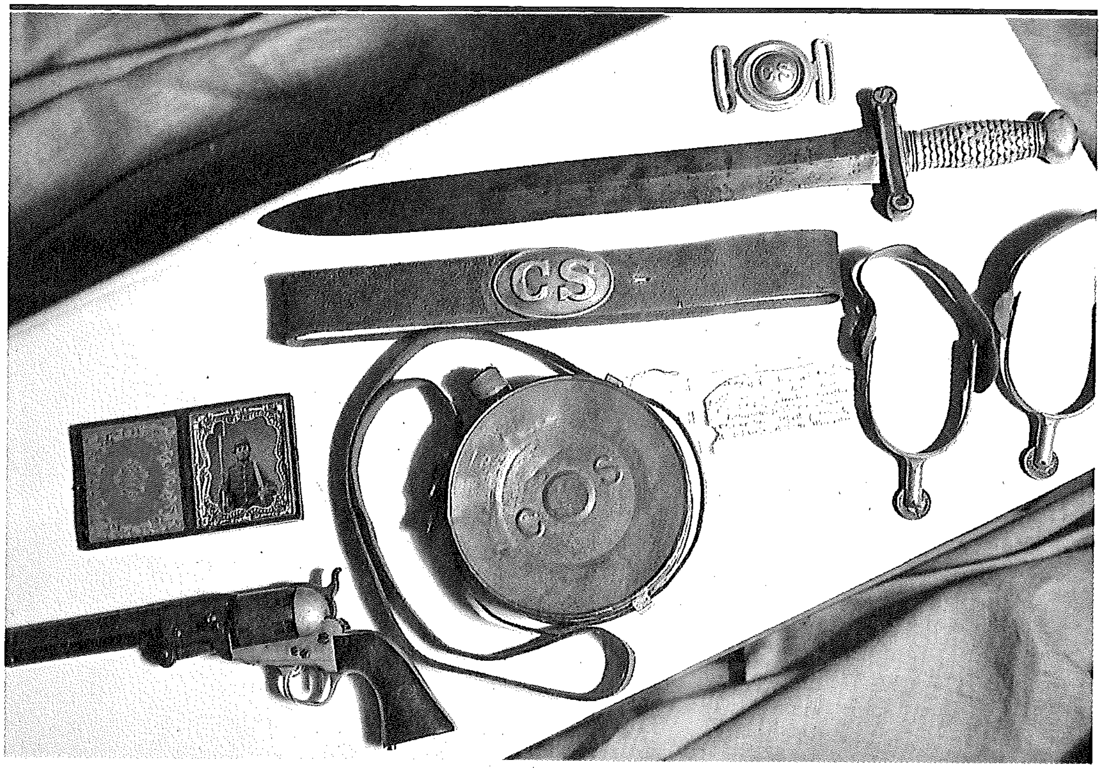
Take Steve Mullinax of Villa Rica, Ga. Armed with a metal detector, a shovel, some old maps and determination, Mullinax has amassed one of the country's finest private collections of Civil War artifacts. Over the past 34 years, Mullinax, 46, has unearthed hundreds of items—buttons, buckles, swords, rifles and cannonballs—and continues to find scores of new artifacts every year. Mullinax trades and sells many of his relics at Civil War shows around the country, and has added drums, canteens, uniforms and flags to his collection.

Prices of Civil War memorabilia have been rising dramatically of late, fueled in part by Ken Burns' award-winning television series on the Civil War, seen by over 38 million viewers. Expect another spike after the upcoming miniseries of *Killer Angels,* about the Battle of Gettysburg, to be aired later this year.

The highest prices are paid for Confederate Army artifacts, which have doubled in value in the past five years. Take three standard-issue Confederate relics, all stamped CSA (Confederate States of America): A single, round brass uniform button sells for about $200; a rectangular brass belt buckle fetches $1,400; an enlisted man's sword, $2,800. A Confederate coat can bring up to $30,000, a flag as much as $50,000.

In contrast, comparable Union military gear goes for roughly one-tenth as much. Why? Supply and demand: The North had almost twice the number of troops and roughly five times as many manufacturing plants as the South.

With so much collector interest, it should be no surprise that fakes and reproductions have been flooding the market. Instantly weathered with salt water or battery acid, some fakes can deceive the most knowledgeable experts. Mullinax has an "education drawer" filled with fakes even he has



Ann States/SABA

Mullinax has dug from Mississippi to Virginia for relics

National battlefields are off-limits.

been fooled by. Having recently written a book, *Confederate Belt Buckles and Plates,* on the 400 different styles of Confederate belt buckles known to exist, he gets sent a lot of buckles in the mail for verification. Half of what he sees are fakes. To be safe, Mullinax buys only from dealers who offer money-back guarantees. Among them are R.E. Neville in Mobile, Ala. and Stone Mountain Relics in Stone Mountain, Ga.

Mullinax, who invests in rental property, grew up in rural Georgia and started collecting as a kid. His first finds were cannonballs and iron grapeshot, discovered near his home at the site of 1864's Battle of New Hope Church.

Mullinax says that even after 30 years, he still gets a thrill when he unearths a Civil War artifact. He got a particularly big thrill years ago when he unearthed a real rarity: a Union army belt buckle with a bullet embedded in it.

Exploring for Civil War treasures requires ingenuity, strong map skills and some courage. Digging for relics on state or federally protected battlefields is strictly illegal. So Mullinax transposes old maps (available, he says, in local libraries) made by Civil War engineers onto current topographical maps and sets off after places where Confederate troops bivouacked. Mullinax's relic hunts have taken him through backwoods from Virginia to Mississippi. "I've uncovered plenty of blown-up liquor stills," he says. "You also have to watch out for snakes, wasps and ticks in the summer, and deer hunters in the winter."

Army Sergeant Terry Heilman, now stationed at Fort Myer, Va., is another Civil War artifact hunter who has had notable success since his wife bought him a $450 metal detector seven years ago. Heilman was ecstatic when he dug up 400 square-headed Civil War nails on his first treasure hunt. But he now knows how to sense when the detector is signaling nails, which are virtually worthless.

Virginia is the one of the richest sites for relic hunters. Heilman, 46, has made some great finds around old home sites. His collection includes spurs, stirrups, 3,000 bullets, 2,000 buttons, 45 belt buckles, two cannonballs and two Union soldier identification disks—early dogtags, in effect. On rainy days he researches his finds and swaps leads with fellow members of the Northern Virginia Relic Hunters Association, which meets once a month in Fairfax.

Relic hunters follow some strict rules of conduct: Always fill in the holes you dig, and always get owners' permission to root around on their property. But too many searchers ignore such rules. "A lot of them are vandals," snaps eminent Civil War historian Shelby Foote, who doesn't collect himself.

Network central for relic hunters is the offices of Stephen Sylvia and Nancy Rossbacher who publish *North South Trader's Civil War.* A bimonthly magazine published in Orange, Va., the publication features collectors, ads and a calendar of events. Annual subscription: $25. Tel: 703-672-4845. The couple also produces a biannual price guide on Civil War collectibles. Price: $19.

There are two big upcoming Civil War relic shows. One will be at the Georgia state farmers' market in Jonesboro, Ga., Mar. 27-28, the other at the Ramada Inn in Gettysburg, Pa., July 2-4.

If you're interested in putting the artifacts in context, the best public collections of Civil War memorabilia can be seen at the Museum of the Confederacy in Richmond, Va., the Atlanta History Center and the Louisiana Historical Society's Confederate Museum, New Orleans.

Robert Blazer has built a tiny produce stand into a $50-million-a-year business. But don't try to emulate him—it's too much an extension of his personality.

Zen and the art of fresh produce

By Joel Millman

IN 1971 Robert Blazer spent just two days at the Wharton School before dropping out. It wasn't what he wanted. "The human connection was missing," he says. The school was geared to filling executive slots in big corporations.

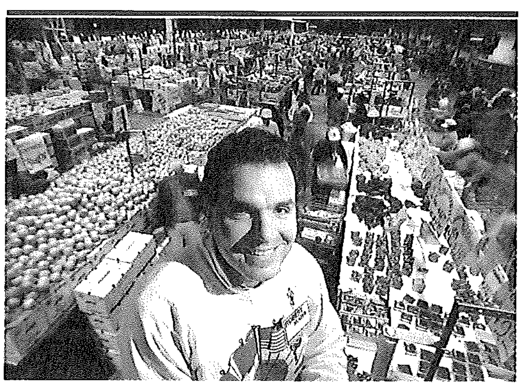
Anyhow, more book learning wasn't what Blazer wanted. He had already earned an engineering degree from the University of Rhode Island. He went home to Pawtucket, R.I. to help run his father's discount department store.

This was more like it. He threw himself into his work, putting in 18-hour days selling dry goods and developing a produce line on the side. When his father, Hyman, went on vacation, Blazer cleared out the basement and added a produce department. He was trying to capitalize on what he saw as an inefficiency in the market. Supermarkets, he felt, were no longer selling produce that was fresh, and small farmers couldn't reach consumers on their own. Blazer recalls: "I saw an opportunity."

He found himself buying fresh stuff from a wholesale market and offering large-volume specials on individual items to make sure the produce moved off the shelves and bins before it went bad.

But Dad's store seemed small and cramped to him. So, at age 28, he decided to start fresh somewhere else. Atlanta, with its rural base and growing economy, seemed perfect. Blazer sold his house, netting $30,000, and put everything into a farm stand in suburban Decatur, where he repeated what he had done in Rhode Island: selling fresh produce cheaply to keep from being underpriced by area supermarket chains. First he bought at the state farmers' market, then convinced local farmers to drop small loads with him on their way to town.

Then disaster struck. A freak ice storm in February 1979 collapsed the market's roof and ruined the inventory. But the insurance didn't cover ice damage—a rarity in Georgia.



Alan Weiner

Produce entrepreneur Robert Blazer
Fresh fruit, philosophy and profits.

Blazer raised capital in a truly novel way: In one of only two ads he has ever run, he asked for donations in personal checks; canceled checks could then be redeemed as food coupons when he reopened. Blazer raised $40,000 in $50 and $100 amounts. He reopened in just eight weeks.

This year Blazer's privately owned Your DeKalb Farmers Market will ring up sales of more than $50 million. Yes, that's from just one store. At 140,000 square feet, the market is a kind of gourmet Wal-Mart specializing in fresh produce and imported condiments like *mole* sauce from Mexico and Italian sun-dried tomatoes. Blazer sells 40,000 pounds of fresh fish and shellfish each week, and 26 varieties of lettuce. He stocks 1,700 wines; cases of imported beers, stacked on pallets, go for $1 a bottle.

Blazer's prices are lower than those of the big chains like Winn-Dixie and Kroger, sometimes by pennies, sometimes by $3 a six-pack of beer. Farmers say his produce is three or four days fresher, usually arriving straight from the farm instead of spending days in a central warehouse.

The market has become a test lab for Blazer's pet theories on workplace harmony. Here, after all, is a businessman who quit business school because it dealt in numbers, not in people. Blazer wants employees to love their work. If employees meet, mate and marry, so much the better. Husband-and-wife teams abound—including Blazer and his new bride, who works in human resources; a third of the employees have relatives working for the market. A new hire gets nearly two weeks' vacation the first year.

What's unique also is that only a handful of his workers are U.S.-born, the rest spread among 36 countries. Blazer finds that a lot of foreigners feel at home working at the market. Name tags that say things like "Patel, I speak Gujarati and Hindi" help foster an exotic image.

Suddenly, this unusual business has competition. It comes from—of all people—Blazer's kid brother, Harry, 42. Using what Robert derisively calls "other people's money," Harry Blazer—who refused to talk with FORBES—has opened two farmer's market clones in nearby suburbs and plans to open more. He has hired some of his brother's staff, and cut into his customer base.

But the personal touch will be missing. Starting on a big scale and in multiple locations, Harry's enterprise can't possibly duplicate the spirit his brother has infused into Your Dekalb Farmers Market. "This is a dance, marrying a perishable food item to customers, and doing it right," Robert Blazer sighs. "You make it mechanical, you kill the whole thing."

Empowered

GENERAL MOTORS' new product programs are mired in delay. Ford's are buried in costs. Yet in just two years, with money and engineers tight, Chrysler has come in with four new vehicle programs and two new engines. "We're coming in on time," says Chrysler's design chief Thomas Gale. "We were never able to do this in my time at Chrysler."

A heap of the credit goes to Francois Castaing, Chrysler's vice president in charge of vehicle engineering. Castaing, 47, is a Frenchman who ran Renault's successful racing program in the 1970s. He moved to Detroit in 1980 as Renault's chief engineer working with American Motors Corp. "What I learned in racing was the ability of small teams to move very fast," he says. "I never thought it took 3,000 engineers to do a car."

At AMC Castaing developed what's become known as the platform team, a tight group of engineers from all disciplines—engines, brakes, chassis—working together and "empowered," the key word, by the corporate hierarchy to make decisions and make them fast.

When Chrysler bought Renault's AMC interest in 1987, Castaing was in charge of engineering for AMC. Lee Iacocca not only kept him on but also asked him to take over engineering for all of Chrysler when the company ran into trouble in 1988. Castaing quickly broke up Chrysler's old engineering departments—"chimneys," he calls them, because they were vertical organizations—replacing them with his horizontal platform teams.

The bureaucracy fought back. Castaing: "The old-timers wrote to Lee. They said, 'Francois is tearing up everything.' It was true. I was."

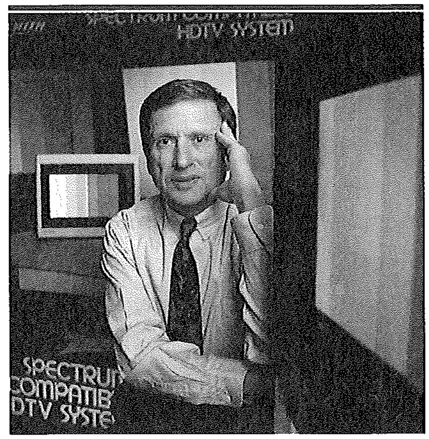
With support from Iacocca and Chrysler President Robert Lutz, Castaing expanded the platform team concept to include manufacturing, suppliers and marketing. He created "technical clubs"—opportunities for brake experts, say, on each team to get together weekly to compare notes. To give his teams the political clout they needed to get things done, Chrysler appointed "godfathers," top corporate officers who do double duty, leading a team as well as doing their regular jobs.

The result is a parade of on-time, on-budget new products: the new Jeep Grand Cherokee last spring, the LH sedans last fall, the big Chryslers coming this spring, and late this year the Dodge Ram pickup and the small Neon car. Chrysler's earnings could exceed $5 a share this year; already the stock has passed 40, almost quadrupling in a year.

Says Bob Lutz: "Francois is the number one agent for change. He's a genuine hero." —JERRY FLINT

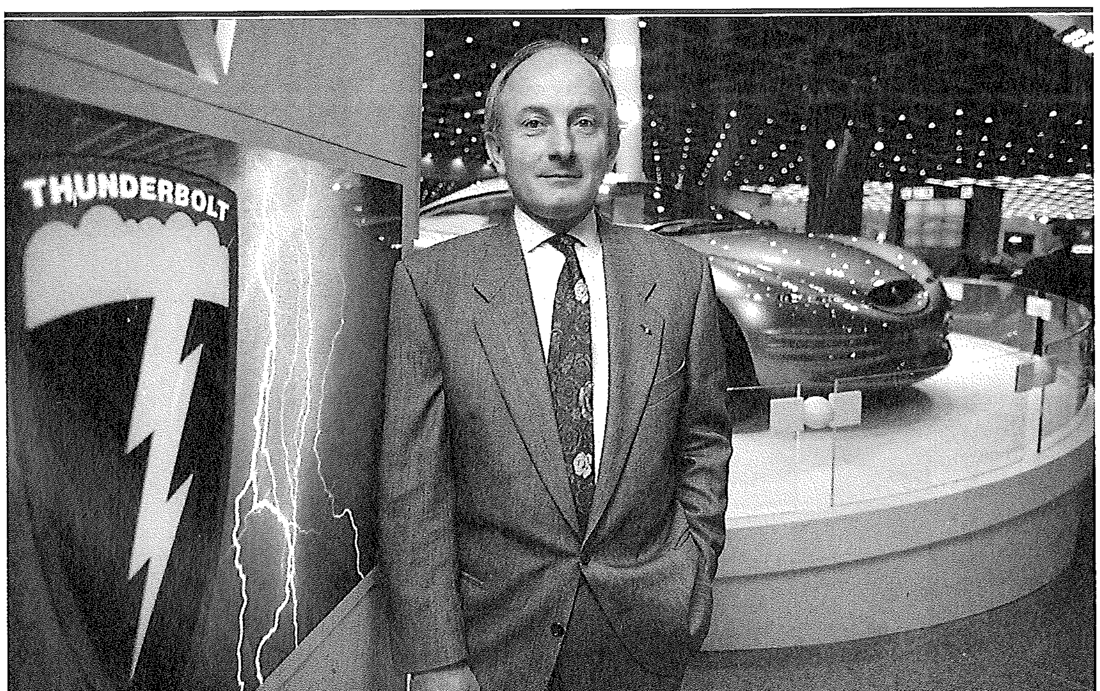
The perils of Pearlman

BADLY BATTERED by television price wars, Zenith Electronics Corp. is once again on the ropes. The $1.2 billion (estimated 1992 sales) TV maker lost enough money last quarter to put it in violation of net worth covenants in its credit agreement with the Bank of New York. Despite this further setback, Zenith's $35 million of 12⅛ bonds due 1995 were recently selling at 91. Buyers are betting that if Zenith Chairman Jerry Pearlman can



Michael L. Abramson

ABOVE: Zenith Electronics' Chairman Jerry Pearlman **Can he keep the sheriff from the door?**



Eric Smith/Gamma-Liaison

LEFT: Chrysler's chief engineer, Francois Castaing **"A genuine hero," says his boss.**

refinance he'll call these high-coupon bonds. Can he keep the sheriff from his door?

"We are talking to the Bank of New York," says Pearlman. "But we are also looking at lots and lots and lots of options. Actively." If his bankers won't renegotiate the credit agreement, Pearlman, 53, thinks he can sell assets or raise new equity, maybe from Korea's Lucky-Goldstar Group, now a 5% owner of Zenith.

If he can get past this financial hurdle, Pearlman has high hopes for Zenith's high-definition TV system. The Federal Communications Commission may soon announce transmission standards, and Zenith's could get the nod. But even if the FCC picks a different system, Pearlman says he can make money on HDTV by licensing technology and selling components to other manufacturers. Meanwhile, Zenith's promising high-resolution monitor for computers is "real close" to turning a profit, Pearlman says.
–GRAHAM BUTTON

Deconstructing black boxes

REMEMBER Leland O'Brien Rubinstein Associates Inc.? The firm pioneered portfolio insurance—the use of options and futures to hedge stock and bond portfolios. By 1987 the firm was managing over $2 billion in institutional portfolios. Then the market crashed. Rightly or wrongly, a lot of people blamed the crash on portfolio insurance and computer-driven trading programs. Within a year or so, Leland O'Brien Rubinstein's assets under management fell from $2 billion to $500 million.

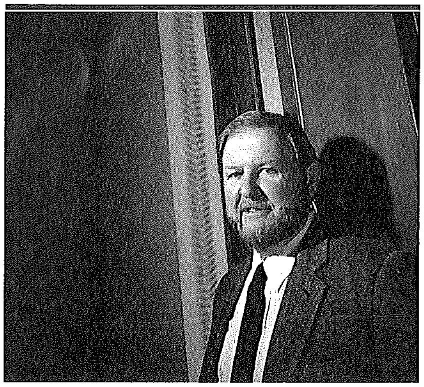
"That was a very difficult time for our firm," says the company's chief executive John O'Brien. "But we felt ultimately that demand for hedges would persist."

Demand did persist, and LOR's assets under management have inched back to $800 million. Now O'Brien says the firm wants to cash in on the huge growth in trading derivative products—everything from puts and calls on French stocks to futures on Asian currencies. It hopes to do so by selling software to audit the complex mathematics inside the black boxes that drive Wall Street's derivatives trading operations.

O'Brien says many senior managers on Wall Street are scared to death that their rocket scientists and traders are booking big profits in derivatives by taking risks that could submerge their firms if they bet wrong. For a fee of $100,000 to $500,000, O'Brien's software will evaluate other firms' portfolios to make sure the underlying assumptions and equations make sense. O'Brien signed his first client for this new service in December.
–LAURA JERESKI

People's mover

FOR OVER TWO YEARS Peter Lynch, the star stock picker who until May 1990 ran Fidelity Investments' $22 billion Magellan mutual fund, has recommended well-capitalized thrift and bank stocks. But one of Lynch's best-performing thrifts is one he never publicly recommended: $163 million (assets) People's Savings Bank of Brockton, a tiny thrift south of Boston. "I wasn't comfortable recommending it," says Lynch. "It was too small. It was also a long shot."



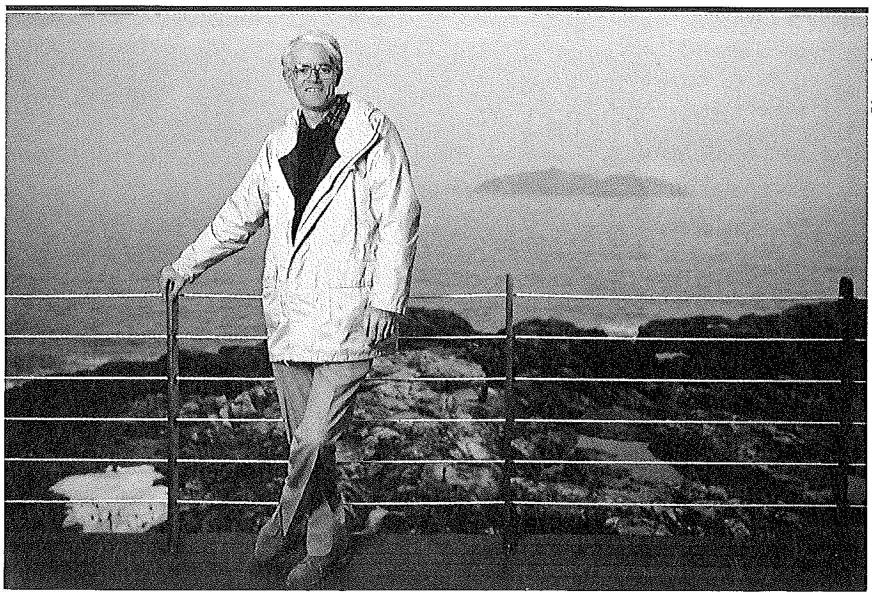
David Burlow

John O'Brien of Leland O'Brien Rubinstein
Life after the October 1987 crash.

People's has lost money for three years, has $17 million in nonperforming assets and bad real estate, and its capital base has been cut in half. But where most people saw weakness, Lynch saw People's underlying strengths. "Here's a company that, after losing an enormous amount of money, still had almost 9% equity-to-assets," he says. "That's better than J.P. Morgan."

Last fall Lynch acquired about 6%—135,000 shares—of People's for his own account. Average price: $2 a share. As word of his buying leaked out through his filings with regulators, the stock began to move. Recent price: 4⅜. "In all honesty," says People's President Roger Kibart, "the stock has traveled on the news of Peter's acquisition."

Lynch says he still likes People's even though he's already doubled his money on the stock. "If you believe the economy in New England is getting better, it's still a good call," he insists. "I didn't buy this for a two-month play."



Abe Frajndlich/Sygma

Stock picker Peter Lynch
"I wasn't comfortable recommending [People's Savings Bank]."

BY ERIC S. HARDY

Investors have been buying small growth stocks. But value stocks have also been doing very well. The S&P/Barra Value stock index was up 10.6% (including dividends) in 1992, compared with 5.1% for Barra's growth stock index.

Robinson-Humphrey market analyst Robert Robbins predicts a 10% correction in the equities markets during 1993 and says this is a good time to stress value—stocks trading at low multiples of earnings and book value. He likes ACX Technologies, recently spun off by Adolph Coors. ACX makes aluminum beer cans, packaging materials and ceramics. At a recent 29¼, it sells for less than book value.

Robbins also likes St. Louis-based Mercantile Bancorp, which trades at 12 times earnings and 1.6 times book value, and yields about 3%. For comparison, the market as a whole trades at 26 times earnings and 2.4 times book value.

Special focus

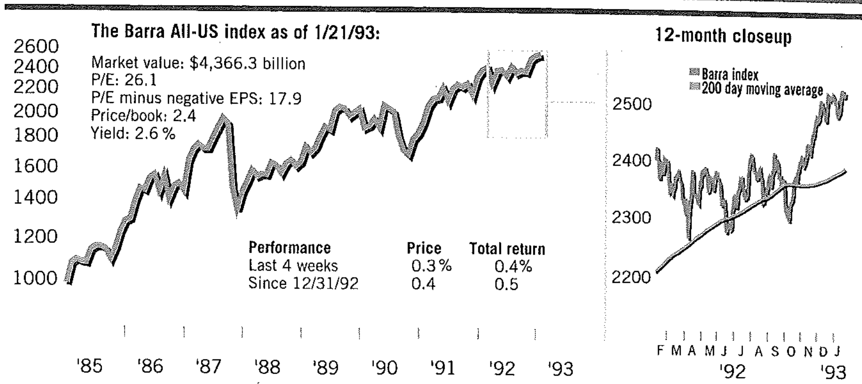
In 1983, seven of the ten most profitable U.S. corporations were oil companies. This year the Institutional Brokers Estimate System expects that only one U.S.-based petroleum company, Exxon, will be in the top ten. If the analysts are correct, the most profitable firm in 1993 will be Philip Morris, with $5.8 billion in net income.

Great expectations

Company	Estimated 1993 profits
Philip Morris	$5.8 bil
General Electric	5.2
Exxon	5.0
AT&T	4.3
Merck & Co	2.9
Bristol-Myers	2.5
Wal-Mart	2.4
DuPont	2.4
Coca-Cola	2.3
GTE	2.1

Source: IBES

The overall market



Closeup on the market

Index or investment	2-week change	% change from 1 year ago	% change from 5-year high
Barra All-US index	1.5%	5.4%	-0.1%
S&P/Barra Growth index[1]	0.9	5.6	-2.9
S&P/Barra Value index[2]	1.4	10.3	-0.2
Dow Jones industrials	-0.5	0.8	-4.7
S&P 500	1.1	4.9	-1.3
NYSE	1.1	4.8	-0.9
Nasdaq	3.3	12.5	0.0
Amex	2.1	-2.1	-3.2
EAFE[3]	-0.9	-13.1	-29.9
CRB futures index[4,5]	-0.5	-4.6	-26.0
Gold[5]	0.2	-7.2	-34.5
Yen[5] (per $US)	-0.3	1.1	-23.9
Oil[5]	-0.8	0.5	-54.3

The best and worst performing stocks[6]

Best	Price	2-week change	1993 EPS[7]	Worst	Price	2-week change	1993 EPS[7]
Creative Technology	29½	56%	$1.16	Centorcor	7½	-59%	$-1.91
Anchor Bancorp	14⅜	47	NA	Damon	13¼	-36	1.31
City National	9¾	47	0.47	IMRS	16½	-34	0.80
Peoples Westchester SB	33	47	1.52	Walker Interactive Sys	13¾	-29	0.71
InaCom	20	43	1.86	System Software	18	-27	1.21

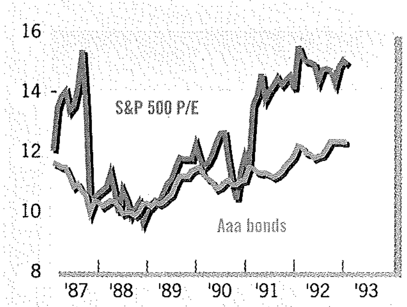
The best and worst performing industry factors[6,8]

Best	2-week change	Since 12/31/92	Worst	2-week change	Since 12/31/92
Photographic, optical	16.0%	22.3%	Aerospace	-5.6%	-6.9%
Thrifts	10.2	5.6	Air transport	-4.3	-4.0
Real estate	7.6	3.0	Tire & rubber	-4.2	-3.5
Trucking	6.1	7.3	Aluminum	-3.7	-4.7
Electric utilities	5.1	2.5	International oil	-2.5	-2.9

Note: Data for period ending 1/21/93. The Barra All-US index consists of all publicly traded common stocks for which price quotations are available and ordinary shares of foreign stocks trading on U.S. markets. ADRs, REITs and closed-end funds are excluded. [1] Total return of a portfolio of more than 150 large-capitalization stocks that has high historical earnings growth and has predicted above average earnings growth. [2] Total return of more than 300 large-capitalization stocks characterized by low price-to-book ratios, high yields and low price-to-earnings ratios. [3] A dollar-denominated capitalization-weighted index of more than 1,000 stocks from Europe, Australia, New Zealand and the Far East. Source: Morgan Stanley Capital International Perspective. [4] Index of 21 commodity futures. [5] Knight-Ridder Financial Information. [6] During the last two weeks. [7] Estimate. Source: Institutional Brokers Estimate System, from IBES, Inc. [8] Shows return to the industry factor after controlling for other influences, including company size, value and growth characteristics. Multi-industry firms have proportional contributions in two or more groups. NA: Not available. Principal source: Barra, Inc., Berkeley, Calif.

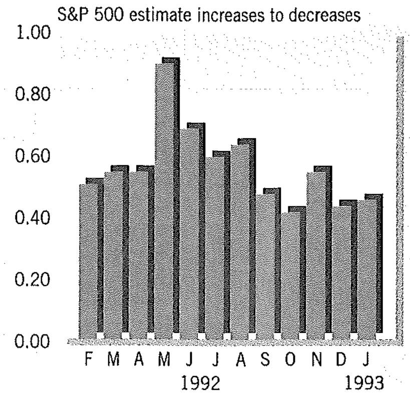
BY STEVEN RAMOS

S&P 500 P/E* vs. Aaa bonds†



*S&P 500 P/E is the recent price of the S&P 500 divided by estimated earnings over the next 12 months. †Actual and projected price-to-coupon ratio for Moody's Aaa corporate bond index.

IBES estimate revisions index



Forecasting the S&P 500

Year	Estimated P/E	% change current vs. 3 months ago	Expected year-to-year EPS growth
1992	18.7[1]	-4%	12%[1]
1993	15.0	-5	25
1994	12.6	0	19

1993 estimates for IBES industry groups

Rising estimates	Falling estimates
semiconductors	airlines
home building	computers
health care-misc	paper containers
toys	aluminum
department stores	steel

The analysts had their rose-colored glasses on again last year. A year ago consensus earnings forecasts put the 1992 earnings of Standard & Poor's 500 index at $28. Now it looks as if the S&P will turn in a net of just over $23 before nonrecurring charges, and about $22 after.

Still, the analysts might be useful in showing the trend, if not the magnitude, of earnings. Consider the revisions index put out by the Institutional Brokers Estimate System. This is the ratio of earnings estimate increases to estimate decreases on S&P 500 member companies. Not surprisingly, the ratio is well below 1.0—that is, analysts are constantly backtracking.

Nonetheless, here's an encouraging sign: For the twelfth consecutive month, the revisions index is higher than it was during the same month a year earlier. For instance, in January this index stood at 0.45, up from 0.24 in January 1992.

The analysts are now saying the S&P 500 will earn $29 this year, up 25% from 1992. Don't bet on it, but a more modest gain may well be in the cards.

Who's hot

Greatest increase in estimates over the past three months

Company/industry	1992[1] EPS	1993 estimate recent	1993 estimate 3-month change	1993 estimate P/E	3-month price change	Reason
Biogen/biotechnology	$0.98	$0.91	72%	49	24%	Higher royalty payments
DSC Comm/telecom equip	0.20	0.78	56	29	79	Increased sales
Chrysler/automobiles	1.41	3.24	38	11	49	Strong demand for new models
Roosevelt Finl Group/savings & loan	2.92	3.59	27	8	45	Attractive acquisitions
SynOptics Comm/computer equip	1.97	3.06	26	27	53	Higher sales of networking products

Who's not

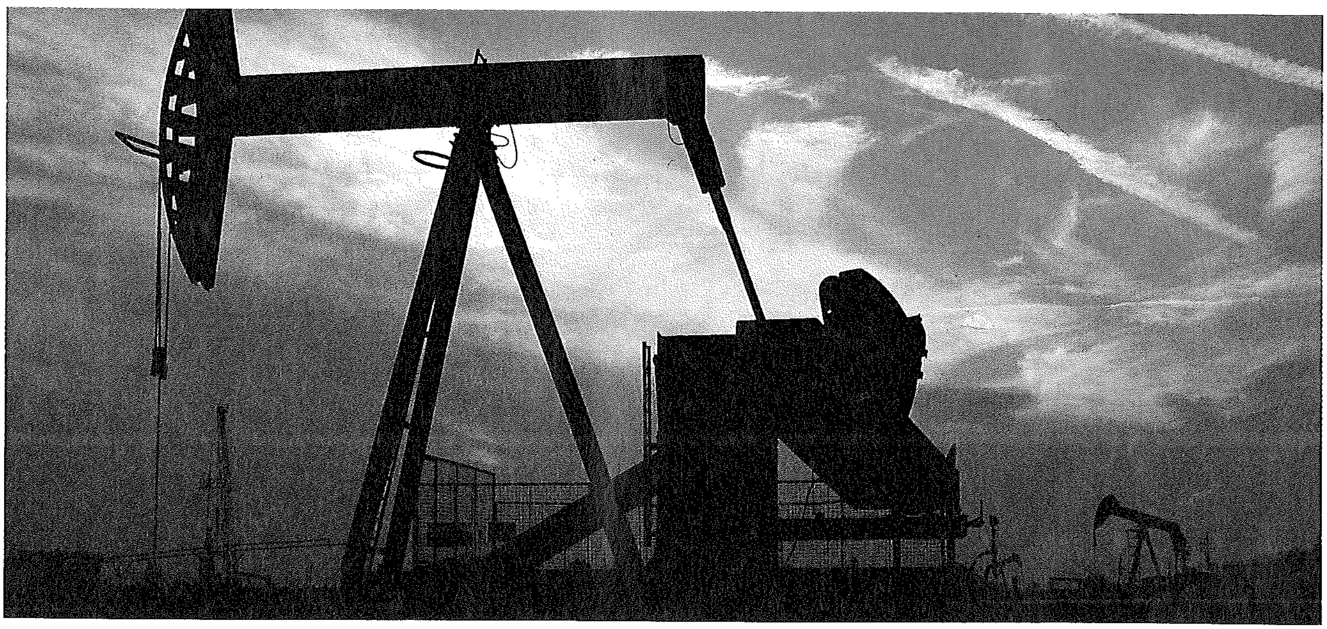
Greatest decrease in estimates over the past three months

Company/industry	1992[1] EPS	1993 estimate recent	1993 estimate 3-month change	1993 estimate P/E	3-month price change	Reason
Inco Ltd/nickel & copper	$-0.12	$0.40	-72%	54	1%	Oversupply of nickel
Storage Technology/computer equip	0.61	0.99	-66	21	-12	Weak sales, delays in new products
IBM/computers	2.49	2.90	-62	16	-39	Decline in mainframe demand, pricing pressures
Telxon/hand-held computers	0.02	0.66	-59	18	-8	Increased product development costs
Borland Intl/software	0.09	1.07	-53	18	-37	Disappointing sales of new programs

Note: Companies listed have a market capitalization of $100 million or more. [1]Estimate. Earnings projections are Wall Street consensus estimates data from 3,000 security analysts compiled by the Institutional Brokers Estimate System, a service of IBES, Inc. Aaa bond yield forecasts supplied by Blue Chip Economic Advisors. NA: Not available or applicable.

From Totally Elegant

To Extra Crude



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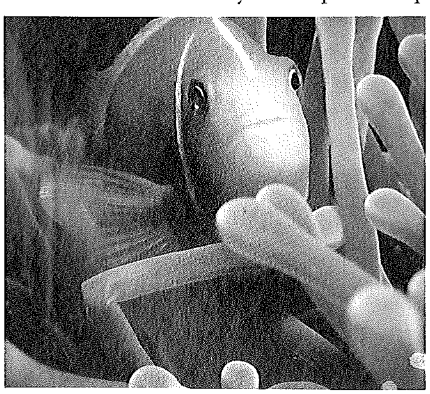

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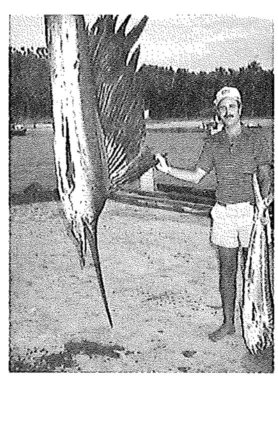

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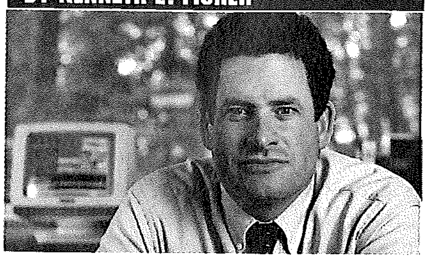
People who say there aren't many cheap stocks left aren't looking very hard.

Acres and acres of bargains

BY KENNETH L. FISHER



Kenneth L. Fisher is a Woodside, Calif.-based money manager. His third book is *100 Minds that Made the Market.*

FOR ALL THE TALK about this being a high-priced stock market, I find more cheap stocks out there than I can shake a stick at.

Regular readers know I have been a rabid long-term bull for the last 27 months. I still am. Furthering 1992's trend, I expect the best part of the market will continue to be smaller, cheap stocks of firms that are fundamentally strong in their underlying business. Hard to find?

There isn't space here to detail all the good, small stocks that look darned cheap to me. So many that, ranking them alphabetically, I run out of space even before I get to D. Starting with A:

The market values computer giant *Amdahl* (8) at merely $875 million. Five years ago? Value: $2.5 billion. It had $1.8 billion in annual sales then. Now? Sales: $2.8 billion. Yes, the company has hit some snags lately, like almost everyone in computing, but I think it can earn $150 million in a few years and keep growing. It's a strong firm.

At 38% of trailing revenue and 65% of book value, Amdahl is darned cheap. More so as you note that its balance sheet looks like a rock. Its depreciation is so large relative to long-term debt that if it chose to, it could use this source of cash flow to pay off all its debt in just nine months. Most firms would need at least five years to do this.

Amax (18) was well regarded 12 years ago at 65—or $4 billion for the whole natural resources firm. Now, down 75%, its total price tag is $1.5 billion, but it's still a fine company. At the current depressed price, it is a cheap stock today at just 42% of revenue and 72% of book value.

American Maize-Products (23) is likely to be taken over before long—if not by its peer, *Archer Daniels Midland* (27), which seems likely, then by someone else. At 25% of sales, a P/E of 10, and 85% of book value, American Maize shares should do well whether taken over or not.

Ameron (34), a leader in concrete water and sewage pipe, has had tough times lately with the economy and the budget woes of local governments. It should see pickup in demand ahead, and increases in its currently modest foreign sales. Selling well below its 1988-90 peak prices, at 14 times earnings, 30% of revenue, 90% of book value, and with a 4% dividend yield, it could well hit 50 by 1995.

I cited *Black & Decker* (17) two years back *(June 10, 1991)* at 12. It broke through 26 and has now given much of that back, retreating from the big-cap world again. But 32% of revenue, 1.1 times book value and 9 times what I think it can earn in 1994 is simply too cheap for a truly great consumer products franchise. Expect a 100% rise by 1995.

I'm not politically correct, because I love the logging industry, having studied at forestry school before switching to economics. I love the woods, the smell, the sound, the thud and the feel of a big tree felling. And I love *Blount* (14) and its role as perhaps the world leader in commercial logging products. Its $169 million total price tag is too low for its logging line; but you get its sporting equipment and construction lines, too—$700 million in sales all told. I think by 1995 Blount could earn $20 million and the stock be at 30. It was at 20 a decade ago.

CDI (9) leads in two areas that should be hot in the years ahead. Its temporary employment services will hum—from the economic upturn—and from tax incentives to hire long-term "temps" instead of "permanent" help. In a cost-conscious world, contingency-fee executive search (CDI is the biggest) will gain share from the "retainer" side of the industry. Valued at $175 million, CDI sells at 20% of sales, 1.6 times book value and 11 times what I think it can earn next year. Hold out for 15.

If you want 15 stocks to put away and not worry about, don't own *Comdisco* (14). But if you own 75 stocks and watch them closely, this computer leasing firm is a good risk, despite the debt inherent in leasing. At 27% of sales, 8 times earnings, 95% of book value and with potential for fat profit margins, Comdisco should hit the high 20s by 1995.

Commercial Metals (27). Times have been tough for the metal industry, and with over 50 plants this firm has had more than its share of the troubles. But at 23% of sales, one-third over book value, and 10 times its basic earning power, the stock looks cheap.

Property and casualty insurers are becoming too cheap. An example?

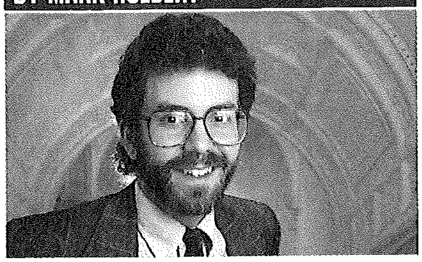
Continental Corp. (27). At 29% of revenue, 75% of book value and with a 4% yield, it's at less than 10 times what it used to earn in the casualty cycle's last upleg. The stock is half its 1986 price and below where it was ten years ago. The company is well run, and the stock could easily hit 50 by 1996.

No cheap stocks left out there? What do you call these? All from A through C. There are about 100 more between D and Z. Out of space. ■

This letter writer's promoters ask whether he has the highest IQ on Wall Street. If he does, this just proves that intelligence has nothing to do with telling the truth.

Leeb's fairy tale

BY MARK HULBERT



Mark Hulbert is editor of the Alexandria, Va.-based *Hulbert Financial Digest*. His newest book is *The Hulbert Guide to Financial Newsletters* (Dearborn Financial Publishing).

I HAVE RECEIVED an enormous amount of mail recently about advertising claims made by Stephen Leeb. He's a big deal in the advisory-letter business. He grinds out two separate investment letters, *The Big Picture* and *Personal Finance,* with a combined circulation of several hundred thousand. He also manages the Leeb Personal Finance Fund.

Leeb is no shrinking violet. In one promotional piece he claims to have turned $10,000 into more than $39 million between 1980 and 1991—equivalent to a 390,900% gain, or 99% per year compounded. In another, beside a blown-up photo of Leeb, his publisher asks whether he has "the highest IQ on Wall Street." Wow!

Actually, Leeb hasn't done too badly by his clients, but his claims are outrageously exaggerated.

Leeb's advertising includes a table that supposedly reports the actual dates of his buy-and-sell signals and insists that his claim "is a public record—with real numbers." The publishers of Leeb's investment letters have announced they would award $10,000 to the first person who can "make us aware of anyone beside Stephen Leeb who has multiplied any portfolio, real or paper, more than 390,900% between Jan. 1, 1980 and today, using any technique, but announcing the required advice in advance in a scheduled publication."

The publisher's $10,000 is safe. Not even Warren Buffett has come close to 390,900% in that decade. But neither has Stephen Leeb.

The *Hulbert Financial Digest* calls Leeb's weekly telephone hot line updates—and tapes and transcribes them. So we have a clear record of Leeb's calls. The record reveals that Leeb's claimed accomplishment is an after-the-fact reconstruction using the benefit of hindsight.

For example, Leeb's advertising explains that his phenomenal return was calculated assuming that an investor in the futures market went 500% long during each of his buy signals. (That is, using leverage to control $5 of stock for each $1 in the investor's portfolio.) But since 1987, when he started writing *The Big Picture,* he has never recommended being 500% long during any of the buy periods identified by his advertising. In fact, his average recommended exposure during these periods was less than 150%—or less than one-third of what his advertising must assume in order to claim Leeb turned $10,000 into more than $39 million.

Not only did Leeb never recommend a 500% position during the periods of his buy signals, but not all of those periods were identified by him as buy signals at the time. During some of the weeks that his advertising says he was strongly bullish, for example, Leeb actually was on a sell signal. During others, his model was "dead neutral"—to quote his own telephone hot line messages.

By rewriting his record after the fact Leeb tarnishes what is otherwise a creditable record. Leeb's "Short-Term Trading Portfolio"—the one that supposedly turned $10,000 into more than $39 million over 12 years—gained a very respectable 160% over the last five years. This makes it one of the select few portfolios that beat the Wilshire 5000's total return of 105%.

Why would Leeb's publishers feel compelled to exaggerate a record that is this good? The answer, according to many other advertisers: Investors aren't all that excited by what is realistically attainable. Leeb's five-year return of 160% equates to "just" 21% a year, for example. Such advertisers say they can't compete with others who are lying or exaggerating if they honestly reported gains like that.

This self-serving argument does not justify lying to investors. It is a naked appeal to gullibility and greed. Long-term performances above 25% per year compounded are exceedingly rare. The top-performing investment letter since 1980 among those tracked by the HFD—Dan Sullivan's *The Chartist*—achieved just a 19.3% compound rate of return. The top-performing equity mutual fund over the last decade—CGM Capital Development—produced a 20.5% annual rate of return. This is what the very best did in one of the most bullish decades in history. It is fantasy to hope for anything significantly above this.

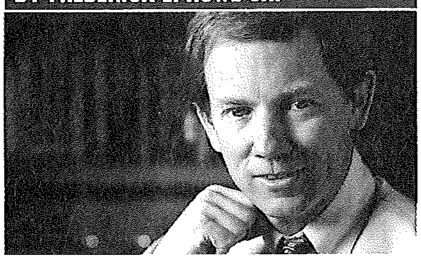
In any case, however, I'm baffled by why advertisers consider it difficult to sell a compounded rate of return of 20% to 25%. Such returns are more than sufficient to turn even modest sums into substantial fortunes. Compounded at 20%, for example, $10,000 becomes $60,000 in 10 years and approaches $400,000 after 20 years. Any advertiser worthy of the name ought to be able to make that very attractive indeed.

The bottom line? Ignore advertising that makes extravagant claims. Check the actual record; it will often tell a quite different story.

At GM, Sears and American Express, investor unhappiness has at last been translated into management changes. These will not be the last.

Hurrah for October 15

BY FREDERICK E. ROWE JR.



Frederick E. (Shad) Rowe Jr. is the general partner of Dallas' Greenbrier Partners, a hedge fund.

IF THE HISTORY of the American shareholder is ever written, Oct. 15, 1992 is a day that will live gloriously in the hearts and minds of shareholders everywhere. By changing proxy solicitation rules and by changing disclosure requirements for executive compensation, the Securities & Exchange Commission on that date ushered in a new era of shareholder activism, the implications of which are bullish for the long term.

The last spate of shareholder activism ended badly. During the years 1986-89, big shareholders routinely and successfully demanded that managements of companies in which they held stock act to "maximize shareholder values." That, of course, was code for selling out or leveraging up their balance sheets in order to pay up for their own shares. Risk arbitragers and junk bond dealers did well for a time, but it is hard to see how much good came of the era.

To paraphrase Delaware corporation law, as a matter of law, the duty to manage a corporation resides in its board of directors. What happens when directors fail to carry out their duty effectively? Until the changes that took place in October, most managements and most boards of directors took the attitude, "If you don't like the way we run the company, sell your stock."

A disgruntled shareholder was left with two other unappealing options. He or she could sue for fraud, waste, mismanagement, etc.—all of which are expensive to litigate and difficult to prove. Or the disgruntled shareholder could propose an alternative slate of directors and mount an allout proxy fight. This alternative is even more expensive than litigation and the range of possible outcomes is even more complex.

At the risk of oversimplifying, big and small shareholders may now communicate freely with each other without fear of breaking proxy solicitation rules, disclosure rules and who knows what other rules, thereby creating a litigation and regulatory quagmire. Warning: Before instigating a grassroots shareholder movement of your own, you should check out your plans with a competent securities lawyer.

The impetus for changing the rules largely came from huge quasi-indexed public pension funds, which really can't sell big positions, even if they want to. After all, they are indexed. They are "stuckholders." Since they can't sell, what they want is effective management and executive compensation that relates to executive performance. Among public pension funds seeking rule changes, Calpers (California Public Employee Retirement System) has been the noisiest.

Thus if you are a "stuckholder," you can agitate for change much more effectively than before. Further, in proxy materials that will shortly be mailed for companies whose fiscal years just ended, management must fully disclose its total compensation and relate its compensation to performance. Proxy materials, for example, must include a graph of the company's financial performance over the preceding five-year period as it relates to executive compensation. Further, the company must relate its compensation to comparable companies. There are far too many companies whose revenues and earnings have gone nowhere, while the pay of their executives has gone through the roof.

Outside directors, rather than serving as yes-persons for the strong executives who hired them, are going to have to be far more diligent. In fact, many outside directors have started retaining outside counsel in order to brief themselves on their obligations and responsibilities. Increasingly, directors who don't own material amounts of stock and who routinely collect large directors' fees for little work are going to be sent packing.

General Motors is an example in which the board has belatedly become actively involved in doing its duty. Other prominent examples are American Express and Sears. Better late than never.

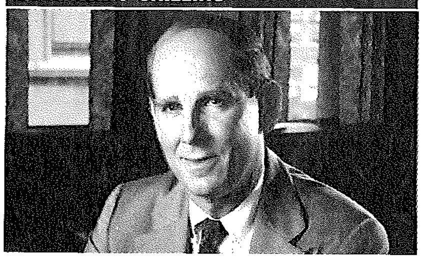
Does this new activism threaten a management's ability to manage? Not at all. It is reasonable to expect a management to clearly communicate its business and financial strategies to its owners. It is reasonable to expect a management to invest its discretionary cash flows profitably. It is reasonable to expect a management to eliminate fat and extravagant perks. It is reasonable to relate compensation to performance. If a company is not doing what is reasonable, its shareholders will now legally be able to get together in order to forcefully instruct their directors.

A brief list of big companies whose shareholder grumbles may increase would include *American Brands* (37), *Ensearch* (14), *W.R. Grace* (38) and *McGraw-Hill* (60).

A frank self-appraisal of where I went wrong and where I went right in the year just past.

Scoreboard

BY A. GARY SHILLING



A. Gary Shilling is president of A. Gary Shilling & Co., economic consultants and investment advisers. His firm publishes *Insight*, a monthly newsletter covering the business outlook and investment strategy.

REVIEWING my recommendations for last year, I've got to own up to a few miscalls. My June 22 column said that small companies have outperformed their larger brethren only when high inflation and low productivity growth robbed big-company earnings. These conditions don't prevail now, so I doubted that small stocks would continue to outperform.

Nevertheless, small stocks are up sharply. Since I wrote that column, the Russell 2000 index of small stocks has jumped 22%, while the big-cap S&P 500 has gained only 8%.

Here's where I went wrong: Small firms tend to sell domestically, and are not subject to the negative effects of recession abroad and the strengthening dollar that are plaguing big internationals. I foresaw a strong dollar and global recession, but missed the connection between that and big/small company relative performance.

I also erred in my Aug. 3 column putting down auto stocks. As I predicted, car sales have remained weak, what with the vehicles of the late 1980s still too young to junk, and with debt-weary consumers not willing to incur more auto debt. But Chrysler has doubled. I'm a long-term bull on American business restructuring but underestimated Chrysler management's success at cutting costs and bringing out new products. GM is down 10% from then, but even the staid auto giant is shedding costs after the boardroom coup threw out the old management.

I was, in part, early in recommending short- and long-term German debt instruments in my Nov. 9 column. The German economy is declining, but I leaped ahead to foresee monetary ease and didn't figure on the intransigence of the Bundesbank. Short-term German rates haven't fallen. At the same time, German bond prices have risen almost 2%.

In general, however, my 1992 prognostications came out well. My "recessionist's portfolio," introduced in my Sept. 18, 1989 column and updated in my Nov. 11, 1991 and Nov. 9, 1992 columns, rose 15.5% through year-end, while the S&P 500 gained only 4.5%.

Specific elements of this portfolio did nicely in 1992, even after I wrote about them. My Sept. 14 column recommended the dollar, the traditional safe haven in a sea of global economic and political troubles. Dollar index futures have climbed 17% since I wrote. My Apr. 27 column reiterated my long-held belief that Japan in the 1990s has restructuring problems that rival those of the U.S. in the 1930s. The Nikkei put warrants I plugged then are up 22% to date.

My Jan. 20, 1992 column recommending long-term U.S. bonds came out well. Since then, long-term Treasury holders have enjoyed a 7.75% yield, plus 5.5% appreciation—not bad for a risk-free investment.

Beyond my "recessionist's portfolio," other 1992 investment suggestions have been fruitful. My Mar. 30 recommendation that renting would be better than buying vacation condos was on target. Single-family houses are just abodes and no longer surefire investments as well, my Nov. 23 column advised. Many now agree, as they rush to refinance 30-year mortgages with 15-year maturities, thereby reducing their financial leverage much faster.

My Oct. 12 column warned against accepting the word of a corporate chieftain when he announces that a big restructuring writeoff would wipe the slate clean. The first restructuring writeoff is seldom the last, I said, and cited IBM. Enough said.

My May 25 column emphasized the shift in national emphasis from preserving life at any cost to medical cost control. Since then the medical shorts I suggested have fallen 17%, while the stocks I recommended have risen 23%. "Productivity is the buzzword of the 1990s," my June 22 column said; the high-tech productivity enhancers listed there are up 15%.

Increasingly protectionist trade blocs and the strong dollar will hurt multinationals, my Dec. 21 column warned, but NAFTA makes Mexican investments exciting. I recommended Teléfonos de Mexico, up 5% since then, and Mexico Fund, up 13%, including a special dividend. Not bad for one month's work.

My 1992 record, then, was good on balance but not perfect. I'm learning from that experience and hope you can too. For 1993 I see more of the same in the U.S. with a stop-go economy that keeps inflation low and bond prices rising. The zeal for productivity will, if anything, grow. Clinton will add to the pressure for medical cost control. The postwar housing boom is over, and the recent runup in lumber prices has given us the chance to short lumber futures in portfolios we manage.

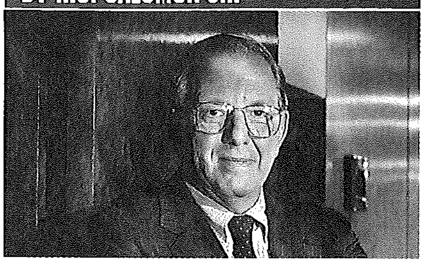
Elsewhere, Mexico continues to look bright, but the deepening recession in Europe means that the surest investment winner for 1993 is a sharp decline in short-term rates there. Hedge your positions against a strengthening dollar, however. In Japan, many hope that ongoing government stock purchases and enthusiasm over the Crown Prince's wedding will save the day. Grasping at straws! The Nikkei may well drop 50%, to 8000.

Above all, in 1993 remember this: Markets can remain irrational a lot longer than you and I can remain solvent.

With their well-publicized problems, a group of financial stocks sell at a sharp discount to the market. There are good buys in this group.

Turnaround time

BY R.S. SALOMON JR.



R.S. Salomon Jr. is chairman and chief executive of Salomon Brothers Asset Management Inc. and portfolio manager of Salomon Brothers Capital Fund Inc. Research assistant: Caroline Davenport.

MOST FINANCIAL service stocks sell at prices that appear quite reasonable in view of these firms' earnings prospects and the valuation level of the overall market. I recommend a group of financial stocks that sell at an average 33% discount to the S&P 500, based on estimated results for 1993.

The news of mergers and layoffs among financial companies has become commonplace and the painful disruptions associated with this consolidation process have been felt in many parts of the country. This particular cloud does have a silver lining, however. As operations are streamlined and made more productive, profit prospects are enhanced.

The interest rate picture also appears to provide a favorable backdrop for investing in financials. Today's low level of rates will not last once the economy picks up speed, but increases in rates are likely to be restrained by subdued inflation. Recent downward pressure on oil and gold prices provides confirmation of a low-inflation environment that is likely to persist for some time.

A cyclical pickup in the economy has benefits as well as drawbacks. While it may boost interest rates somewhat, stronger growth in the individual and corporate sectors will translate into higher demand for products and services. In addition, a pickup in growth ameliorates credit-quality problems.

Our recommendations in the financial services sector fall into three groups: insurance companies, banks and thrifts, and broad-based services.

In the aftermath of last year's disasters, pricing in the insurance business is finally beginning to firm. Even without a pickup in inflation, this industry looks as though it will have some pricing flexibility over the next few years. Our recommendations in this group—*W.R. Berkley* (43), *Horace Mann* (27) and *Integon* (30)—are all specialty insurers.

W.R. Berkley's management seeks to offset the vagaries of the underwriting cycle by balancing its regional insurance and insurance services, which tend to be somewhat stable, with specialty operations that are more cyclically sensitive but are also potentially more profitable. The stock sells at 14.1 times estimated 1993 earnings of $3.05 per share. Berkley could earn as much as $7 to $8 at the peak of this underwriting cycle.

Horace Mann provides teachers with automobile, homeowners and life insurance. The company operates principally in suburban and rural areas. The shares trade at just over 13 times estimated 1993 profits of $2.05 to $2.10 per share, a 20% discount to the market multiple. An investor group, which still owns 45% of the shares, bought Horace Mann from Cigna in 1989, and the company was brought public in 1991.

Integon provides "nonstandard" automobile insurance to customers who have been rejected or whose policies have been canceled by standard carriers. The company typically provides less coverage than a standard carrier and thus there is less risk attached to each policy. Moreover, Integon is a very low cost producer, so it enjoys a considerable pricing advantage. The shares trade at 15.8 times estimated per-share profits of $1.90 in 1993. The company went public last February.

The consolidation in the banking industry is far from over. Most countries have a small number of banks, while the U.S. still has thousands. At current levels, two stocks—*Standard Federal* (24) and *Central Fidelity* (42)—look particularly attractive.

Standard Federal is the largest thrift in the Midwest. For several years, management has chosen to emphasize retail products and services, and has thus limited its exposure to commercial real estate and multifamily loans. Credit quality is high: Standard Federal's nonperforming assets amount to just 0.78% of the total, compared with 4.3% on average for the industry. The stock trades at less than half the market's price/earnings multiple, based on estimated results of $3.30 per share this year.

Central Fidelity operates over 200 banks in Virginia and has demonstrated a remarkably consistent pattern of earnings increases, despite the downturn in the economy. Profits could advance by 16%, to $3.90 per share, in 1993. The stock trades at a 35% discount to the S&P 500 multiple.

At current prices I also like the *Foothill Group* (9). Foothill provides financing to distressed companies that banks will not lend to. The company has leveraged the analytical expertise it has acquired here by expanding into asset management, a more stable business that is likely to boost the stock's multiple as the contribution to profits from this source increases. Foothill trades at 8.2 times forecast results of $1.10 in 1993—less than half the market's level.

With its well-publicized problems, *American Express* (24) appears to be at a crossroads. I believe, however, that the company will emerge considerably stronger as a result of internal restructuring and cost-cutting, and the beneficial impact of an economic pickup on the level of credit card charges. American Express' shares trade at just 9.4 times estimated 1993 results of $2.55 per share—nearly a 40% discount to the market. ■

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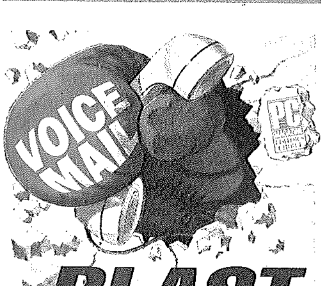

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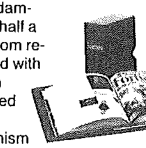
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A smarter LTV play

HOPING TO SCORE when LTV Corp. emerges from seven years in Chapter 11 bankruptcy protection, investors recently piled into LTV's common and preferred shares. Dumb move. According to LTV's recently filed reorganization plan, the company's current equity will be all but wiped out.

Alex. Brown & Sons' distressed-securities chief Peter Faulkner says that there's a much smarter way to play LTV: Buy unsecured LTV Corp. bonds, which trade on the New York Stock Exchange.

Faulkner particularly likes LTV's senior unsecured 15s of 2000. There is $100 million worth of the issue outstanding; each $1,000 bond currently sells for $165. Faulkner says if the company's reorganization plan is approved, each bond will be converted into 12.25 shares of new LTV common stock, plus some warrants valued at $16.40.

With the bonds selling at $165, the market is valuing LTV's to-be-issued common at around $12 a share. But Faulkner believes the new common will be worth at least $17 a share—he predicts LTV will generate $250 million of cash flow in 1994. If he's right, then each bond should be priced closer to $225. Potential return: around 36% within six months for those buying the bonds today.

Faulkner wouldn't sell his new stock right away. During its bankruptcy, LTV invested some $3 billion in steel plant and equipment and is now one of the most efficient producers. Steel prices, moreover, are just now beginning to rise. "This is the third-largest steel company in America," says Faulkner, "and yet hardly anyone on Wall Street follows it."

–MATTHEW SCHIFRIN

Levitating

CAN ANY STOCK that has more than quadrupled over the past 12 months and now trades at 27 times anticipated year-ahead earnings still be worth buying? Montgomery Securities analyst Betty Lyter says yes, if the company is Acclaim Entertainment, Inc.

Headquartered in Oyster Bay, N.Y., Acclaim makes videogame cartridges for the Nintendo and Sega game systems. Acclaim's cartridges include such popular titles as *Aliens 3*, *Terminator 2*, *WWF Super WrestleMania Challenge* and *Bart's Nightmare* (as in *The Simpsons*).

Acclaim Entertainment videogames
What can the stock do for an encore?

Acclaim has been hot. For the 1992 fiscal year ended last Aug. 31, sales rose 76%, to $215 million. For the first quarter of fiscal 1993, ended Nov. 30, both sales and earnings per share were up 87% over a year ago. Reflecting this, the stock has roared from around 5 in January 1992 to a recent 22¾. There are 28 million fully diluted shares outstanding.

So why does Lyter still recommend Acclaim? The company, she notes, plans to introduce about 60 new titles in fiscal 1993. Plus it is growing well overseas, mainly in Europe; nearly half of sales are now booked abroad. The company also has landed the videogame license for *Mortal Kombat,* a big hit at video arcades. Finally, Acclaim's greatest growth is in the sale of cartridges for 16-bit videogame systems, fast dominating the market as they supplant the less powerful 8-bit systems.

Lyter predicts that Acclaim will earn 85 cents a share in fiscal 1993, and $1.05 a share the year following.

Any hot stock selling at a fancy multiple is vulnerable to the slightest disappointment—especially if the current hot market for small growth stocks cools off. Still, Lyter thinks Acclaim will continue to rise over the course of 1993. In this kind of market, she might be right. Then again. . . .

–MICHAEL SCHUMAN

Recovering

LAST YEAR $888 million (sales) papermaker Chesapeake Corp. suffered on several fronts. Market prices for pulp slipped more than $100 per ton since midyear. This cost the Richmond, Va.-based company, which produces roughly 100,000 tons more pulp than it uses, some $2 million in the fourth quarter. Also, Sweden and Finland, two big pulp-producing countries, devalued their currencies in 1992. That depressed pulp prices, which remain low.

Bottom line: For the year, Chesapeake earned a mere $14 million, or 63 cents a share, from operations—and that was before an extraordinary charge of $10 million for pension and tax accounting changes. Chesapeake's stock has sunk to a recent NYSE price of 20, down 31% from its 12-month high of 29⅛.

But at these levels Michael Beall smells opportunity. Beall, who covers the company for Richmond-based Davenport & Co., likes Chesapeake because it concentrates on niche products like commercial tissue and point-of-sale cardboard displays. It also holds a 20% share of the mottled white linerboard market, a business that's growing 7% a year. Companies increasingly favor white boxes for shipping because they can display printed advertising. Beall expects tighter capacity in white linerboard by midyear, leading to higher prices.

Another plus: Last year Chesapeake deleveraged somewhat by selling $60 million worth of new stock and paying

down debt. (There are now 23.3 million shares outstanding.)

Beall estimates Chesapeake will earn $1 a share this year. Recently selling at 20 times that anticipated figure, the stock certainly doesn't appear cheap. But note that the recovery is in its fairly early stages. In decent years, Chesapeake earns well over $2 a share. And while you're waiting, the stock's dividend yield is 3.6%.

—LAURA JERESKI

Power play

TUCSON ELECTRIC Power Co. (estimated 1993 revenues, $650 million) made a mess of itself in the late 1980s. Efforts to diversify into nonregulated industries went nowhere. Arizona utility regulators disallowed or pared down requested rate increases. Debt piled up. Management was accused of self-dealing. Since 1989 the company has lost money every year. Tucson Electric's NYSE-listed stock had traded at 65 in 1986. By last year it had collapsed to 1⅜.

Finally, in 1990 new management led by Charles Bayless arrived. Under a restructuring plan adopted in December 1992, Tucson Electric's lending banks eased their terms, and massive amounts of new common stock were issued to creditors and preferred shareholders. There are now 160 million common shares outstanding; recent price, 3¾.

Mark Luftig, a utilities analyst for Kemper Securities, likes the stock. Luftig thinks earnings will gradually rise. He estimates the company will lose 11 cents a share this year but start to make money again in 1994. But don't expect a resumption of Tucson Electric's dividend. For the next few years the company's available cash flow—an estimated $40 million in 1993—will go to paying down its $500 million of long-term debt.

Mind you, Luftig isn't looking for a killing. He thinks Tucson Electric shares will reach 7 sometime in 1998—with the stock recently at 3¾, that's a compound annual rate of return of about 12%. But Luftig is telling his clients not to buy until the price dips below 3. Given the stock's volatility as creditors dump their new shares, that level might well be reached. —WILLIAM P. BARRETT

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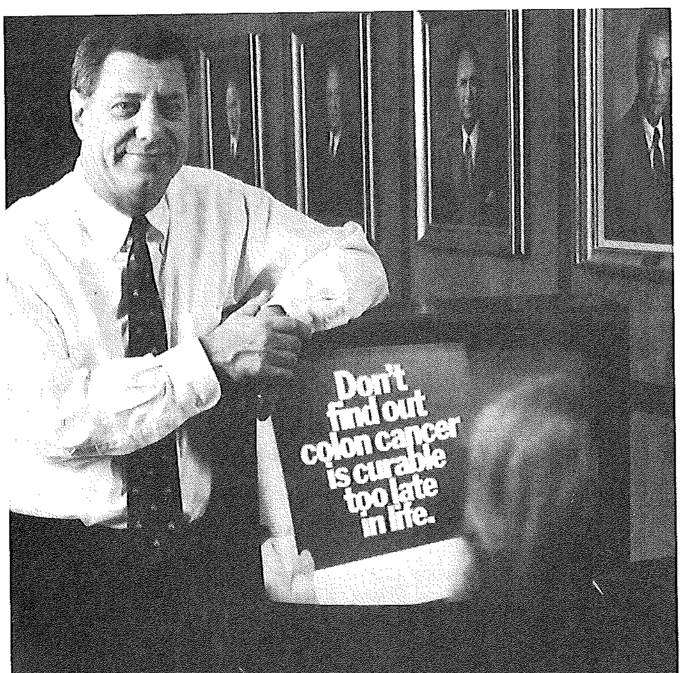
"Colon cancer is a disease that afflicts more than 150,000 Americans each year and eventually kills over half. Yet, any doctor will tell you that with early detection, the survival rate could be raised to as much as 90%.

Can advertising have the power to make people confront this disease, overcome their fear and actually consult their doctors about it?

"If you doubt the power of advertising I suggest you consult a doctor."



Herb Baum, Pres., Campbell North & South America and Chm. of the Advertising Council.

You bet your life it can.

Take the case of the Advertising Council's campaign against colon cancer. The first-ever study of public service advertising that actually isolated the impact of advertising from other market elements like the news, editorials and public relations.

Research was conducted from July 1989 to July 1990 in 4 markets in 10,000 households, at the equivalent of $21.3 million worth of air time, the average amount of donated time behind Advertising Council spots.

After six months of being exposed to one commercial, awareness of colon cancer among adults 40 and over rose from 11% to 29%.

After a year, awareness reached 40%.

The number of men who consulted their doctors more than doubled to 15%.

Now, if advertising can get people to see their doctors about something as unpalatable as colon cancer, don't you think it can get people to consider your product?

Oh, there's one more thing. If you're over 40, ask your doctor about colon cancer."

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This advertisement was prepared by Calet, Hirsch & Ferrell, Inc., New York, New York: Photo: Fred Weber.

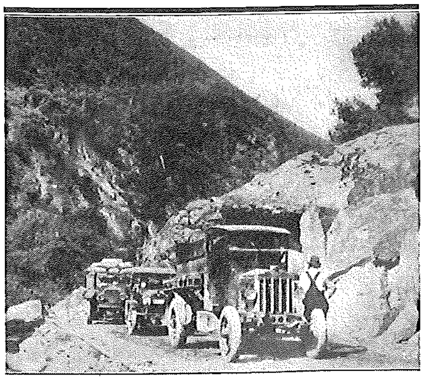
FLASHBACKS

EDITED BY DERO A. SAUNDERS

"The more things change . . ."

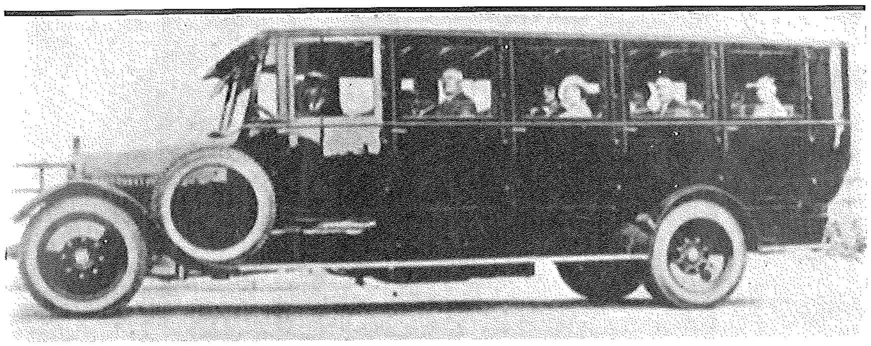
70 years ago in Forbes

(From the issue of Feb. 17, 1923)



In 1923 there were only some 24,000 miles of "improved" (mainly gravel-topped) roads in the U.S.

"**In six branches** of work the need of haulage by motor power greatly exceeds the supply. It is known that each job could be done best in that way, but it is done by rail or with horses, or it is not done at all."



This bus, used in western national parks, was a forerunner of the bus industry.

"**The public** will tolerate from small concerns treatment which [it] will not tolerate from capitalistic giants; and if this democracy is to permit the multiplying of mergers, those conceiving and managing them will have to exercise the most scrupulous regard for the rights—and the susceptibilities—of the electorate. The ballot, after all, is more powerful than any monopolistic trust."

60 years ago

(From the issue of Feb. 15, 1933)

"**Even the oldest** veterans never before experienced times like these. They are inclined to lose heart. Not so new-generation leaders. They refuse to become paralyzed by any thought that the world will never right itself again. 'Tis tough going, yes. But every cloud, they irrepressibly proclaim, has a silver lining, every deflation has been followed by reflation, every panic has been followed by prosperity."

"**They call it** 'Bobby Jones' Golf Course, the new Augusta National. Attending its official opening last month, I learned that, far from its being a moneymaking venture for him, he has poured his own money and his own time into it unstintedly without any thought of financial reward, motivated purely by . . . his yearning to build the finest, most varied, most attractive golf course in the world."

50 years ago

(From the issue of Feb. 15, 1943)

"**Is a fourth term** for President Roosevelt in the offing? Wendell Willkie isn't the only citizen who believes so. As I see it, all will depend upon what happens war-wise during the next 15 months. Should we still be waging all-out war when nomination time comes, a fourth term would probably result."

"**Soon after the war** America will launch into a new era in radio. New FM and television broadcasting stations will spring up from coast to coast; millions of people will be flocking to buy new radio and television receiving sets. Two-way radios will find a new civilian market; television schools and theaters will enter the thriving scene; the amusement and advertising worlds will be revolution-

"Distant early warning" in World War II meant using these giant ears.

ized, and new fortunes are going to be made by enterprising men [now obscure] in the business world."

25 years ago

(From the issue of Feb. 15, 1968)

"**It may not please** General de Gaulle, but French investors contributed $100 million or so last year to help the U.S. balance of payments. They did so by buying U.S. corporate securities faster than they sold them."

"**In the [cruise] season** the boom started—the season ended June 30, 1959—143,561 passengers sailed aboard cruise ships from U.S. ports—135,682 Americans, 7,879 foreigners. In the season ended June 30, 1967, the figure was 363,879, including 339,476 Americans. . . ."

10 years ago

(From the issue of Feb. 14, 1983)

"**Businessmen** rank right behind gangsters as TV villains, according to a study of 263 prime-time shows by two George Washington University professors, Linda and Robert Lichter: 'A stock criminal type is the businessman whose selfish pursuit of profit leads him into illegal activity. TV businessmen and their underlings account for almost one in four lawbreakers with identifiable occupations.' "

"**James Gould,** president of the Washington Federals in the new U.S. Football League, makes the point unblushingly: 'Let's face it, we're in the software business, not the football business.' That is one way of acknowledging the real inspiration for the new professional football league that kicks off an 18-week regular season on March 6."

There's one post-Christmas chore I love—writing "Thank you" letters. . . . Lots of companies for many reasonable reasons, I guess, have a policy against sending even Christmas cards, never mind things, at Christmastime. But our clan gets a big kick out of opening the Warner-Lambert box containing an assortment of their wares; we argue over which of the boys is to get the Union Oil Co. necktie [and] all the holiday long we play the marvelous Christmas music sent by Goodyear. . . . None of these things means that FORBES *or Forbeses have been "had." But all of us like being thought of.*

–MALCOLM FORBES

A Text...

But as it is written, eye hath not seen, nor ear heard, neither have entered into the heart of man, the things which God hath prepared for them that love him.

–I CORINTHIANS 2:9

Sent in by Dr. Robert G. Wirth, Upland, Calif. What's your favorite text? *The Forbes Scrapbook of Thoughts on the Business of Life* is presented to senders of texts used.

There are a good many real miseries in life that one cannot help smiling at, but they are the smiles that make wrinkles and not dimples.
–OLIVER WENDELL HOLMES

There is no failure except in no longer trying.
–ELBERT HUBBARD

Trouble will come soon enough, and when he does come receive him as pleasantly as possible. Like the tax collector, he is a disagreeable chap to have in one's house, but the more amiably you greet him the sooner he will go away.
–ARTEMUS WARD

Philosophy triumphs easily over past evils and future evils; but present evils triumph over it.
–LA ROCHEFOUCAULD

Better be wise by the misfortunes of others than by your own.
–AESOP

In time of prosperity
friends will be plenty;
In time of adversity
not one in twenty.
–JAMES HOWELL

A smooth sea never made a skilled mariner.
–ENGLISH PROVERB

Once upon a time my opponents honored me as possessing the fabulous intellectual and economic power by which I created a worldwide depression all by myself.
–HERBERT HOOVER

There is the greatest practical benefit in making a few failures early in life.
–THOMAS HUXLEY

When the world is destroyed, it will be destroyed not by its madmen but by the sanity of its experts and the superior ignorance of its bureaucrats.
–JOHN LE CARRE

If fortune turns against you, even jelly breaks your tooth.
–PERSIAN PROVERB

If at times our actions seem to have made life difficult for others, it is only because history has made life difficult for us all.
–JOHN F. KENNEDY

The new generation forgets the spectres that may have tormented the old.
–HALLDOR LAXNESS

An earthquake achieves what the law promises but does not in practice maintain—the equality of all men.
–IGNAZIO SILONE

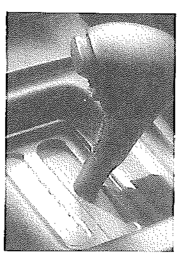
There are three modes of bearing the ills of life: by indifference, by philosophy, and by religion.
–CHARLES CALEB COLTON

In every kind of adversity, the bitterest part of a man's affliction is to remember that he once was happy.
–BOETHIUS

By trying we can easily learn to endure adversity. Another man's, I mean.
–MARK TWAIN

THINK OF IT AS CAVIAR FOR THE POWER HUNGRY.

FORD TAURUS SHO



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If you crave power with more than a hint of sophistication, may we suggest the 1993 Ford Taurus SHO? With the new, uniquely engineered automatic transmission or the 5-speed manual, the Taurus SHO promises an unforgettable taste of the road.

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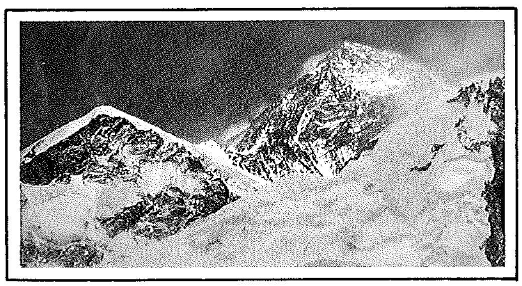
Climber seen at 24,000 feet on the icy east face of Everest.

The Inexhaustible Challenge of Everest.

Tibetans had long called it Chomolungma, "Goddess Mother of the World," but it wasn't until 1852 that British surveyors identified it as the highest point on the planet. Thirteen years later the mountain was renamed for Sir George Everest, Surveyor General of India from 1830 to 1843.

To early climbers, the great peak was doubly remote. Its sheer height made it as inaccessible as the mountains of the moon. Moreover, Tibet barred outsiders until 1920, and Nepal prohibited access until 1951.

The southern route was at last successfully climbed by Sir John Hunt's expedition in 1953. On the day that Edmund Hillary and Tenzing Norgay stood together on the roof of the world,

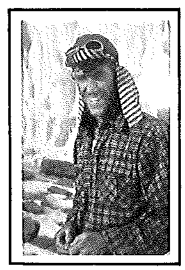


Earth's highest peak as viewed from Kala Pattar.

it seemed Everest could challenge man no longer.

But there were still untried climbing techniques and untried routes. In 1963, the American Expedition was the first to ascend the west face and, in 1978, climbers achieved the first ascent without oxygen tanks, beginning the so-called "purist" approach.

One thing that cannot change is the simple fact of Hillary and Tenzing's breakthrough success. In its honor, 35 years later almost to the day, another team put a man on the summit of Everest. Unlike their famous predecessors, they climbed without extra oxygen and established a new route up the treacherous east face.



Sir Edmund Hillary, 1953.

Although they traveled different routes by different means, both teams marked the times of their historic Everest ascents with Rolex Chronometers.

As an interesting footnote to history, Tenzing's son reports that his father's timepiece continues to run in excellent condition.

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